TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1962

No. 240

ANDRE MAXIMOV, ETC., PETITIONER,

vs.

UNITED STATES.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 10, 1962
CERTIORARI GRANTED OCTOBER 8, 1962

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Civil No. 152-144

ANDRE MAXIMOV, as Trustee for the benefit of H. Robbin Fedden u/a dated 10/24/47, Plaintiff,

v.

UNITED STATES OF AMERICA, Defendant.

DOCKET ENTRIES

DATE	PROCEEDINGS
Oct. 28–59	Filed complaint and issued summons.
Nov. 12–59	Filed summons & return, served USA by (Rolnitzky) and by reg. mail to Atty. Gen'l 10-30-59.
Dec. 28–59	Filed answer of deft
June 20–60	Filed pltff's. affdvt. and notice of motion for summary judgment ret. 6-28-60
Aug. 22–60	Filed attorney's notice of change of firm name
Oct. 28–60	Filed notice of motion for summary judgment ret. 11-1-60
[fol. 2]	
Jan. 4–61	Filed Opinion #26568 denying deft's motion & granting pltff's motion for summary judgment. So ordered—MacMahon, J.—mailed notices of entry 1/4/61
Jan. 4–61	Filed amended & supplemental affdt. of H. R. Fedden in support of pltff's motion
Jan. 4–61	Filed exhibit & stip. making pltff's exh. A part of record for summary judgment

DATE	PROCEEDINGS
Feb. 28–61	Filed notice of appeal from judgment in USDC on 1-4-61 mailed copy to Hill, Betts, etc.
Mar. 8–61	Filed order & judgment #64079 pltff have judgment against deft. USA in the sums of $53.10 and $1,316.32 together with lawful interest thereon and that pltff. have execution therefor, MacMahon, J. Judgment entered 3-8-61 Clerk
Apr. 10–61	Filed stip & order extending time to file record on appeal to 5/26/61—Palmieri, J.

[fol. 3]

IN UNITED STATES DISTRICT COURT

COMPLAINT—Filed October 28, 1959

* * * * * * *

1. Plaintiff brings this action against the United States of America for the recovery of income taxes illegally and erroneously assessed and collected from the plaintiff. Plaintiff is a citizen of the United States and jurisdiction is conferred upon this Court by 28 U.S.C. 1346(a)(1).

2. Plaintiff's claim is for the recovery of $53.10 and $1,316.32 in principal amount of income taxes illegally and erroneously assessed and collected from the plaintiff for the calendar years 1954 and 1955, together with interest thereon.

3. Plaintiff duly filed United States Fiduciary Income Tax Returns for the years 1954 and 1955 with the District Director of Internal Revenue for Lower Manhattan, New York, and duly paid the taxes shown due thereon in the sums of $53.10 for 1954 and $1,316.32 for 1955.

4. On or about February 10, 1958, plaintiff filed with said District Director of Internal Revenue claims for refund for $53.10 for the year 1954 and $1,316.32 for 1955. Copies of such claims for refund are attached hereto as Exhibits A and B.

5. Under date of August 28, 1959, said District Director of Internal Revenue sent plaintiff notices of disallowance of said claims.

[fol. 4] 6. The facts upon which said claims are based are as follows:

a. The taxes paid herein were for capital gains from the sale of securities.

b. The beneficiary of the trust herein is an Englishman and resides in the United Kingdom and is a non-resident alien of the United States, not engaged in trade or business in United States.

c. The Income Tax Treaty between the United States and the United Kingdom (Article XIV) provides that gains from the sale of capital assets by a non-resident alien individual who was a resident of the United Kingdom are exempt from the federal income tax.

7. No part of the aforesaid $53.10 and $1,316.32 of income taxes illegally and erroneously assessed and collected from the plaintiff for the years 1954 and 1955 have been refunded to the plaintiff.

8. By virtue of the aforesaid, the United States became and now is indebted to the plaintiff in the full amounts of $53.10 and $1,316.32 with interest as provided by law.

Wherefore, plaintiff claims judgment against the defendant in the sums of $53.10 and $1,316.32 with interest thereon as provided by law.

[fol. 5]

Exhibit A, Annexed to Complaint

Claim

To be Filed With the District Director Where Assessment Was Made or Tax Paid

* * * * * * *

Name of taxpayer * * * —Trust f.b.o. H. Robbin Fedden U/A dated 10/24/47 Andre Maximov, Trustee

Number and street—26 Broadway

City, town, postal zone, State—New York 4, N.Y.

1. District in which return (if any) was filed—Same

2. Name and address shown on return, if different from above—Andre Maximov Trustee U/A for H. Robbin Fedden, c/o Irving Trust Co. (as Custodian), one Wall Street, New York 15, N.Y.

3. Period * * * —From January 1, 1954 To December 31, 1954.

4. Kind of tax—income.

* * * * * * *

7. Amount to be refunded—$53.10 and interest

* * * * * * *

9. The claimant believes that this claim should be allowed for the following reasons: See sheet attached

* * * * * * *

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed Andre Maximov
Trustee f.b.o. H. Robbin Fedden
U/Adtd 10/24/47

Dated Feb. 10, 1958

* * * * * * *

[fol. 6] Capital gains from the sale of securities were included as income in the fiduciary tax return (form 1041) of this trust for 1954.

The beneficiary of this trust is an Englishman, who resides in the United Kingdom. All capital gains realized by this trust are retained as corpus.

The income tax treaty between the United States and the United Kingdom (Art. XIV) provides that gains from the sale of capital assets by a non-resident alien individual who is a resident of the United Kingdom are exempt from Federal income tax.

This exemption has been held to apply to capital gains realized by a trust for beneficiaries residing in the United Kingdom and retained as corpus of the trust (*American Trust Co. v. James G. Smyth and U.S.A.*, U. S. Court of Appeals 9th Circuit, No. 15,339, decided July 8, 1957, reported at 1957 C.C.H. Standard Federal Tax Reporter, Para. 9824).

If capital gains are excluded from the tax return of this trust for 1954, there is no taxable income for 1954. The corrected computation follows:

Total income originally reported		$3,023.00
Deduct net gain from sale of capital assets (item 8 (b))		1,131.05
Corrected income		1,891.95
Total deductions reported	$2,609.38	
Deduct long-term capital gain deduction (item 20)	565.53	
Corrected deductions		2,063.85
Corrected taxable income		-0-

A tax of $53.10 was paid for 1954, based on the erroneous inclusion of capital gain. The refund thereof, with interest thereon, is respectfully requested.

[fol. 7]

Exhibit B, Annexed to Complaint

Claim

To be Filed With the District Director Where Assessment Was Made or Tax Paid

* * * * * * *

Name of taxpayer * * * —Trust f.b.o. H. Robbin Fedden U/A dated 10/24/47 Andre Maximov, Trustee

Number and street—26 Broadway

City, town, postal zone, State—New York 4, N.Y.

1. District in which return (if any) was filed—Same

2. Name and address shown on return, if different from above—Andre Maximov Trustee f/b/o H. Robbin Fedden U/A dated 10/24/47, 120 Broadway, New York 5, N.Y.

3. Period—From January 1, 1955 To December 31, 1955

4. Kind of tax—income

* * * * * * *

7. Amount to be refunded—$1,316.32 & interest

* * * * * * *

9. The claimant believes that this claim should be allowed for the following reasons: See sheet attached

* * * * * * *

I declare under the penalties of perjury that the claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed Andre Maximov
Trustee f.b.o. H. Robbin Fedden
U/Adtd 10/24/47

Dated Feb. 10, 1958

* * * * * * *

[fol. 8] 1. Capital gains from the sale of securities were included as income in the fiduciary tax return (form 1041) of this trust for 1955.

The beneficiary of this trust is an Englishman, who resides in the United Kingdom. All capital gains realized by this trust are retained as corpus.

The income tax treaty between the United States and the United Kingdom (Art. XIV) provides that gains from the sale of capital assets by a non-resident alien individual who is a resident of the United Kingdom are exempt from Federal income tax.

This exemption has been held to apply to capital gains realized by a trust for beneficiaries residing in the United Kingdom and retained as corpus of the trust (*American Trust Co. v. James G. Smyth and U.S.A.*, U. S. Court of Appeals 9th Circuit, No. 15,339, decided July 8, 1957, reported at 1957 C.C.H. Standard Federal Tax Reporter, Para. 9824).

2. Due to an arithmetical error, the deduction for distribution to beneficiaries (item 18) in the 1955 fiduciary income tax return of this trust was stated to be \$2,623.59; it should have been \$2,624.59, an error of \$1.00.

3. If capital gains are excluded from the tax return of this trust for 1955, and if the correction is made of the error mentioned in 2. above, there is no taxable income for 1955.

[fol. 9] 4. The corrected computation follows:

Total income reported	\$16,700.78	
Deduct net gain from sale of capital assets (item 8 (b))	13,776.18	
Corrected income		\$2,924.60
Total deductions reported	8,890.28	
Deduct long term capital gain deduction (item 20)	5,966.69	
	2,923.59	
Add error in deduction for distribution to beneficiaries (it. 8)	1.00	
		2,924.59
Corrected taxable income		–0–

A tax of $1,316.32 was paid for 1955, based on the erroneous inclusion of capital gain. The refund thereof, with interest thereon, is respectfully requested.

[fol. 10]

IN UNITED STATES DISTRICT COURT

ANSWER—Filed December 28, 1959

The United States of America, by its attorney, S. Hazard Gillespie, Jr., United States Attorney for the Southern District of New York, for its answer to plaintiff's complaint admits, denies and alleges as follows:

I

Admits the allegations in paragraph 1 thereof, except it is denied that any income taxes were illegally and erroneously assessed and collected from the plaintiff.

II

Admits the allegations in paragraph 2 thereof, except it is denied that any part of the amounts of $53.10 and of $1,316.32 were illegally and erroneously assessed and collected from the plaintiff for the calendar years 1954 and 1955.

III

Admits the allegations in paragraph 3 thereof.

IV

Admits the allegations in paragraph 4 thereof, except specifically to deny any statements of fact in the plaintiff's claims for refund that are not admitted in this answer.

V

Admits the allegations in paragraph 5 thereof.

[fol. 11] VI

Admits the allegations in the portion ending with a colon in the second line thereof, also,

(a) Admits the allegations in subparagraph a. of paragraph 6 thereof.

(b) Denies the allegations in subparagraph b. of paragraph 6 thereof, except it is admitted that the beneficiary of the trust is H. Robin Fedden, 20 Eldon Road, W 8, Kensington, W. S., England, a non-resident alien of the United States.

(c) Denies the allegations in subparagraph c. of paragraph 6 thereof.

VII

Denies the allegations in paragraph 7 thereof, except it is admitted that no part of the amounts of $53.10 and of $1,316.32 have been refunded to the plaintiff.

VIII

Denies the allegations in paragraph 8 thereof.

Wherefore, defendant, United States of America, having fully answered prays for judgment in its favor dismissing plaintiff's complaint together with its costs and disbursements and for all other proper and just relief.

[fol. 12]

IN UNITED STATES DISTRICT COURT

STIPULATION OF AUTHENTICITY OF ANNEXED COPY OF TRUST INDENTURE—Filed January 4, 1961

* * * * * * *

It is hereby stipulated and agreed by and between the attorneys for the respective parties that the attached copy of an indenture made the 24th day of October, 1947 and marked Plaintiff's Exhibit A is a true copy of the indenture creating a trust which gives rise to the captioned action, and it is

Further hereby stipulated and agreed that said attached Exhibit A be, and the same hereby is, made part of the record in plaintiff's motion for summary judgment in the

captioned proceeding and in the cross-motion made by the defendant.

Dated: New York, N. Y.
October 25, 1960

[fol. 13]

PLAINTIFF'S EXHIBIT A, ANNEXED TO STIPULATION OF AUTHENTICITY

DEED OF TRUST

THIS INDENTURE made the 24th day of October 1947, between H. ROBBIN FEDDEN, of Polesden Lacey, near Dorking, Surrey, England, hereinafter referred to as "the Grantor", party of the first part, and F. K. MIDDLETON HUNTER, of No. 66 Old South Road, in the Village of Southport, in the Town and County of Fairfield, and State of Connecticut, hereinafter referred to as "the Trustee", party of the second part,

WITNESSETH, that, WHEREAS the Grantor proposes to create a trust of certain personal property hereinafter described, on the terms and conditions and for the purposes hereinafter set forth, and the Trustee is willing to accept the said trust,

NOW, THEREFORE, for and in consideration of the premises, the covenants and mutual agreements herein contained, and for other good and valuable consideration, the receipt whereof is hereby acknowledged, the Grantor has granted, conveyed, assigned, transferred and delivered, and by these presents does grant, convey, assign, transfer and deliver unto the Trustee, and his successors, the property described in "SCHEDULE I" annexed hereto and made a part hereof.

TO HAVE AND TO HOLD all and singular the said stocks, securities and other personal property unto the Trustee and his successors, in trust nevertheless, for the uses and purposes and upon the terms and conditions hereinafter set forth.

[fol. 14] FIRST: To hold the said stocks, securities and other personal property, and to collect the income there-

from, and after defraying the expenses incurred in the administration of the trust, including the Trustee's commissions, to pay the net of the said income quarterly (or at such other periods as the Grantor may in writing direct), to the Grantor for his own use and benefit, during the term of his natural life, and from and after his death to RENEE FEDDEN, the wife of the Grantor, during the term of her natural life (provided at the time of Grantor's death he and his said wife shall be married to each other) and upon the death of the said RENEE FEDDEN, wife of the Grantor, or upon the death of the Grantor should his said wife predecease him or not be married to him at the time of his death, to pay over and deliver the entire principal of the trust to the then surviving issue of the Grantor, in equal shares, per stirpes; provided, however, that if any such issue shall then be under the age of twenty-one years, the share of each of such issue who shall be an infant shall be retained by the Trustee in trust, and paid over to the said issue upon his or her attaining the age of twenty-one years. If there shall be no issue surviving the Grantor, then the Trustee shall pay over the principal to whomever the Grantor shall appoint by will, or if he should fail to do so, to the distributees of the Grantor at the time of the death of the Grantor, as then established by the laws of intestate succession of the State of Connecticut.

SECOND: At any time during the existence of this trust, the Trustee may in his discretion pay over in his absolute discretion, any portion or portions of the principal to the [fol. 15] then life beneficiary, if in the discretion of the Trustee such payments are necessary or desirable to defray any unusual expenses incurred as the result of illness, disability or other emergency affecting the life beneficiary or his wife or children, and, in the case of any beneficiary who may be a minor, to defray the expenses of his or her maintenance or education. The discretion of the Trustee as to all such payments shall be absolute and his decision shall be binding upon all parties interested.

THIRD: The Trustee may cause stocks or securities held by him as a part of the trust estate to be registered

in his name as Trustee, or in the name of a nominee or nominees, or may hold the same unregistered or payable to bearer, and shall receive the income thereon and shall deal with and pay over such income as directed herein.

The Trustee may continue to hold as part of the corpus of the trust hereby created, the shares of stock or securities hereinbefore described and shall not be liable for any loss to the trust estate by reason of the decrease in the value of such stocks or securities, and except as otherwise provided herein, the Trustee may sell the said stocks or securities, or any part thereof, in his discretion.

No purchaser from the Trustee shall be required to see to the application by the Trustee of the purchase money, or to inquire into the validity, expediency or propriety of any such sale.

The Trustee may, in his uncontrolled discretion, distribute the trust estate upon the termination of the trust, in kind or partly in kind and partly in money.

[fol. 16] The Trustee may invest any cash at any time standing to the credit of the corpus of the Trust estate in any securities which he may deem suitable, whether or not such securities are legal investment for trust funds under the laws of the State of Connecticut, or of any other State, and shall not be liable for any loss to the trust estate by reason of any such investment made by him in good faith.

This deed of trust is made subject to the right and privilege of the party of the first part hereto at any time in his discretion during his life, by written instrument signed by him, to change the stocks, bonds or other securities or the relative amounts thereof which shall be held as part of the trust estate as well as to designate the stocks, bonds or other securities in which investments shall be made by the Trustee.

Whenever the Trustee shall receive shares of stock of a corporation by way of a stock dividend upon shares of stock of the same corporation held by the Trustee as a part of the trust estate, or shares of stock of other corporations distributed by way of an extraordinary dividend by an corporation whose shares of stock are held by the Trustee as a part of the corpus of the trust estate, the Trustee shall retain in the corpus of the trust estate all

such stock dividends or extraordinary dividends unless the Trustee shall be advised by counsel that by reason of statutory enactment or construction such retention is in whole or in part an illegal retention of income, in either of which cases the Trustee shall distribute to the persons entitled thereto as income that portion of the stock or extraordinary dividend so received which represents such accumulation.

[fol. 17] In case a corporation, any of whose shares of stock compose a part of the principal of the trust estate, shall issue new or additional stock or other securities with the prior right of its stockholders to subscribe therefor, the Trustee is authorized to subscribe and pay for the whole or any part of its pro rata amount of such stock or securities; proceeds of such rights, if sold, to belong to the principal. If the Trustee is not at the time holding sufficient cash to permit the exercise of his rights by paying for such additional stock or other securities, he may borrow the necessary money upon the credit of the trust estate provided the Grantor if then living shall in writing consent thereto, or the Trustee may sell such amounts of such rights as are needed to enable him to pay for the balance of the rights to which he is entitled.

The Trustee may consent to the reorganization or consolidation of any corporation, or the sale to any other corporation of the property of any corporation, any of whose stocks, bonds or other securities are held by the Trustee hereunder, and may do any act in reference to such stock, bonds or other securities necessary or proper to enable him to obtain the benefit of any such reorganization, consolidation or sale, and in case any of the stock, bonds or other securities so held shall at any time contain an option or options to the holder thereof, or the ownership thereof shall entitle such holder to convert the same into stocks, bonds or other securities, the Trustee may exercise such option or options and make such conversion or conversions and make any necessary payments therefor out of any funds available in the trust estate, and thereafter hold, manage or dispose of such stocks, [fol. 18] bonds or other securities so acquired as a part of the whole of the trust estate.

Whenever the Trustee shall hold as a part of the trust estate any security acquired by him at a premium over face value, no part of the income therefrom shall be deducted or set apart as a sinking fund for the amortization of such premium.

FOURTH: Additional stocks, bonds or other securities, property or moneys may hereafter be added to the trust estate by the party of the first part and shall be taken as a part thereof as fully as if the said stocks, bonds or other securities, property or moneys had been originally transferred and made a part of the trust estate at the time of the execution of this agreement.

FIFTH: The reasonable and proper expenses of the party of the second part as Trustee shall be a first charge upon the income of the said trust estate, and no trustee shall be liable to any person interested in this trust, except for bad faith or wilful default or gross negligence.

The Trustee may at all times, at the expense of the trust estate, advise with counsel and shall be fully protected in respect of any action under this agreement taken or suffered in good faith by the Trustee, in accordance with the opinion of counsel. The Trustee shall not be liable for the exercise of any discretion hereunder or any errors of judgment, nor for any act done or step taken or omitted, under the advice of counsel.

SIXTH: The rights of each and every of the parties at any time interested in the trust estate hereby created shall be [fol. 19] determined, controlled and governed by the laws of the State of Connecticut.

The Grantor covenants and agrees to execute and deliver such other and further instruments of conveyance or assignment as the Trustee may require or deem necessary.

SEVENTH: If at any time the Trustee shall resign or die or become incapable from any cause whatsoever properly to execute the duties and powers herein conferred upon him as Trustee, then and in that event ANDRE MAXIMOV shall become successor Trustee, and as such successor Trustee shall have all the powers of the Trustee hereunder. If the said ANDRE MAXIMOV should for any reason

be or become unwilling or unable to act, the successor Trustee shall be appointed by the then life beneficiary of this trust, or, if such beneficiary be a minor, then by the guardian of such minor.

Eighth: This trust is irrevocable, and may not be amended, except that the Grantor reserves the right to terminate this trust at any time after twenty (20) years from the date hereof, upon six (6) months notice in writing to the then Trustee of this trust.

[fol. 20] In witness whereof, the parties hereto have hereunto set their hand and seals the day and year first above written.

H. Robin Fedden

By /s/ F.K.M. Hunter (L.S.)
Attorney in Fact

/s/ F.K.M. Hunter (L.S.)

Signed, sealed and delivered
in the presence of:

/s/ Andre Maximov

• • • • • • •

[Statement and Signature of Notary Public and Schedule I of Trust Omitted]

[fol. 21] I, F. K. Middleton Hunter, of 19 Old Barn Road, Fairfield, Connecticut hereby resign as Trustee of the Trust Indenture dated October 24, 1947 between H. Romilly Fedden, as Grantor, and myself as Trustee.

January 3, 1955

/s/ F. K. Middleton Hunter

State of New York,
County of New York—ss.:

• • • • • • •

[Statement and Signature of Notary Public Omitted]

I, ANDRE MAXIMOV, hereby consent to act as successor Trustee of the Trust Indenture dated October 24, 1947 between H. ROMILLY FEDDEN, as Grantor, and F. K. MIDDLETON HUNTER, as Trustee.

January 3, 1955

/s/ ANDRE MAXIMOV

State of New York,
County of New York—ss.:

• • • • • • •

[STATEMENT AND SIGNATURE OF NOTARY PUBLIC OMITTED]

[fol. 22]

IN UNITED STATES DISTRICT COURT

AMENDED AND SUPPLEMENTAL AFFIDAVIT OF H. R. FEDDEN—Filed January 4, 1961

• • • • • • •

Great Britain and Northern Ireland,
London, England,
Embassy of the United States—ss.:

H. R. Fedden, being duly sworn, deposes and says:

1. I am both the settlor and the income beneficiary of the captioned trust and submit this affidavit in support of the plaintiff's motion for summary judgment in the captioned proceeding.

2. I am a citizen of the United Kingdom, residing since 1951 at 20 Eldon Road, London W. 8, England. From October 24, 1947, the date of the creation of the captioned trust, to the beginning of 1951, I resided at Polsden Lacey, North Dorking, Surrey, England and have been during this entire period a resident of the United Kingdom for the purposes of United Kingdom tax and at no time have I been engaged in trade or business within the United States.

3. I presently reside with my wife, Renee Fedden, and my infant children, Katharine, age 16, and Frances, age

12, who are my only issue, and have at all times hereinbefore mentioned resided with my said wife, Renee, and my said children, Katharine and Frances at the addresses hereinbefore set forth.

[fol. 23] 4. My wife, Renee Fedden, is a citizen of the United Kingdom, and my issue, Katharine and Frances, are citizens of the United Kingdom.

5. Both my wife, Renee, and my two children, Katharine and Frances, are residents of the United Kingdom for the purposes of United Kingdom tax are not engaged in trade or business in the United States.

6. My wife, Renee, my infant children, Katharine and Frances, and I have not at any time hereinbefore set forth been domiciled in the United States, nor has any one of us been a resident of said United States for any purpose.

7. Since October, 1947, I have been employed by the National Trust for Places of Historic Interest or Natural Beauty; since January, 1951, I have held my present position of Historic Buildings Secretary and have been in the United States only once, that is in October 1958, for a period of about three weeks on a speaking tour on behalf of the National Trust.

H. R. Fedden

Sworn to before me, this Seventh day of November, 1960. Catherine A. Rock, Consul of the United States of America at London, England.

[fol. 24]

In United States District Court

Memorandum Opinion of MacMahon, *J.*—January 4, 1961

* * * * * * *

This is an action to recover taxes paid by the plaintiff in his capacity as trustee for capital gains realized by the trust from the sale of securities in 1954 and 1955.

The parties have stipulated that there are no issues of fact and have cross-moved for summary judgment. The

only question of law involved is whether a trustee of an *inter vivos* trust established under the laws of Connecticut is exempt from taxes on capital gains realized by the trust and applied to the corpus where all of the trust beneficiaries are residents of the United Kingdom not engaged in trade or business in the United States.

The question presented is in all material respects identical to that thoroughly considered and decided adversely to the defendant's position in *American Trust Company* v. *Smyth*, 247 F. 2d 149 (9 Cir. 1957). In that case, the Court held that the intent of the Income Tax Convention between the United States and the United Kingdom, signed April 16, 1945, effective January 1, 1945, 60 Stat. 1377, was to effect full reciprocity and equality of tax treatment between nationals of the two countries. The United Kingdom does not impose an income tax upon capital gains. The Court rejected the government's contention that the trust was a separate taxable entity under United States laws and held the gains exempt since the individual beneficiaries who would feel the economic burden of the tax were entitled to the exemption provided by the treaty. 26 U.S.C.A. §894.

[fol. 25] While not bound by the Ninth Circuit decision, its rationale on the same material facts is a persuasive argument for granting plaintiff's motion. Accordingly defendant's motion is denied and plaintiff's motion for summary judgment is granted. So ordered.

Dated: New York, N. Y.
January 4, 1961

Lloyd F. MacMahon, U. S. D. J.

Judgment entered: 1/4/61

[fol. 26]

IN UNITED STATES DISTRICT COURT

[Title omitted]

JUDGMENT ENTERED MARCH 8, 1961

* * * * * * *

The plaintiff having moved this Court for summary judgment pursuant to the provisions of Rule 56 of the Federal Rules of Civil Procedure and the defendant having served its cross notice of motion for summary judgment and the motions having come on to be heard, and Hill, Betts, Yamaoka, Freehill & Longcope, attorneys for the plaintiff (William F. Suglia, of Counsel) having appeared in support of plaintiff's motion for summary judgment and in opposition to defendant's cross motion therefor, and S. Hazard Gillespie, Jr., United States Attorney for the Southern District of New York (Herbert F. Roth, Esq., of Counsel) having appeared in opposition to plaintiff's motion for summary judgment and in support of defendant's cross motion therefor,

Now, upon motion of Hill, Betts, Yamaoka, Freehill & Longcope, attorneys for the plaintiff, it is

Ordered and adjudged that plaintiff have judgment against defendant United States of America in the sums of $53.10 and $1,316.32 together with lawful interest thereon and that plaintiff have execution therefor.

Dated: New York, New York.
March 7th, 1961.

Lloyd F. MacMahon, U. S. D. J.

[fol. 27]

IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL—Filed February 28, 1961

• • • • • • •

Notice is hereby given that the United States of America, the above-named defendant, hereby appeals to the United States Court of Appeals for the Second Circuit from the judgment herein entered in the office of the Clerk of the United States District Court, Southern District of New York, on the 4th day of January, 1961, which grants summary judgment for the plaintiff.

Dated: New York, N. Y.,
Feb. 28, 1961

[fol. 28]

IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 118—September Term, 1961

Argued November 30, 1961

Docket No. 26984

ANDRE MAXIMOV, as Trustee for the benefit of H. Robbin Fedden u/a dated 10/24/47, Plaintiff-Appellee,

—v.—

UNITED STATES OF AMERICA, Defendant-Appellant.

Before: Clark, Friendly and Kaufman, Circuit Judges.

Appeal from the United States District Court for the Southern District of New York, Lloyd F. MacMahon, *Judge*.

The United States of America appeals from the grant of a refund of income taxes for 1954 and 1955 on an American *inter vivos* trust as being exempt therefrom under Article XIV of the Income Tax Convention between the United States and the United Kingdom. Reversed for judgment for defendant.

[fol. 29] Richard J. Medalie, Atty., Dept. of Justice, Washington, D. C. (Louis F. Oberdorfer, Asst. Atty. Gen., Meyer Rothwacks, Atty., Dept. of Justice, Washington, D. C., and Robert M. Morgenthau, U. S. Atty., S. D. N. Y., New York City, on the brief), for defendant-appellant.

William F. Suglia, of Hill, Betts, Yamaoka, Freehill & Longeope, New York City (John F. Lang, of Hill, Betts, Yamaoka, Freehill & Longeope, New York City, on the brief), for plaintiff-appellee.

Opinion—February 14, 1962

Clark, Circuit Judge:

The taxpayer, Andre Maximov, is the successor trustee of an *inter vivos* trust created in 1947, under the laws of Connecticut, by H. Robbin Fedden. Under the terms of the trust instrument all income is to be paid to the grantor during his life; on his death the income is payable to his wife if she survives him and is still married to him. On her death if she qualifies for this life estate, or on the grantor's if she does not, the entire principal of the trust is to be paid to the surviving issue of the grantor in equal shares, *per stirpes*, with limitations not here relevant. At the time the trust was created, and at all times thereafter, the grantor-beneficiary and his wife and children have resided in England.

During its taxable years 1954 and 1955 the trust realized net long-term capital gains from the sale of securities, resulting in tax liabilities of $53.10 and $1,316.32 respectively. Under Connecticut law these gains were retained

as corpus.[1] Maximov, as trustee, filed federal fiduciary [fol. 30] income tax returns for 1954 and 1955 with the District Director of Internal Revenue for Lower Manhattan reporting these gains, and paid the appropriate tax. Several years later, however, he filed a claim for refund of the tax on these two capital transactions, contending that as the gains were realized by a trust whose beneficiaries reside in the United Kingdom, they are exempt from United States tax under Article XIV of the Income Tax Convention between the United States and the United Kingdom, 60 Stat. (Part 2) 1377.

Under United States tax law the trust is treated as a separate taxable entity. *Freuler* v. *Helvering*, 291 U. S. 35. Income received by the trust and not distributable to the beneficiaries, or not includable in the trust's distributable net income, is taxable to the trust. As the income involved here was neither distributable nor part of the distributable net income of the trust, Internal Revenue Code of 1954, §643(c), these gains are considered the income of the trust, taxable to it, and are not the income of the life tenant or the remaindermen.

The Convention grants an exemption from United States tax on gains from the sale or exchange of capital assets to residents of the United Kingdom not engaged in a trade or business within the United States. Article XIV, 60 Stat. (Part 2) 1384. Were the trust a "resident" of the United Kingdom, as such a resident is defined in the Convention, or were this income includable in the gross income of the grantor-beneficiary, who is a resident of the United Kingdom and not engaged in a trade or business here, the exemption would be clearly applicable. See T. D. 5569, 1947-2 Cum. Bull. 100, §7.519(c). The difficulty which this case presents is that the trust is not a United Kingdom resident and the income here is treated in United States law as that of [fol. 31] the trust.[2] Since the exemption of Article XIV

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[1] Conn. Gen. Stat. Ann. §45-112 (1958).

[2] A resident of the United Kingdom is defined as "any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes

explicitly applies only to *residents* of the United Kingdom, the taxpayer's claim can be sustained only if we disregard the separate tax treatment accorded trusts by United States law.

This is precisely what the taxpayer urges us to do. He asserts that the word "exempt" in Article XIV should be read as signifying a "release from economic burden," and that as the economic burden of the tax falls here on United Kingdom residents—the grantor-beneficiary and his family—the exemption must be read as applying in this case. In support of this contention the taxpayer maintains that one purpose of the tax convention was to achieve reciprocity of tax treatment for the nationals of the contracting parties. Thus, he argues, the aim of Article XIV was to secure for United Kingdom residents realizing capital gains in the United States precisely the same treatment that a United States resident would be given on similar gains realized within the tax jurisdiction of the United Kingdom. Since the United Kingdom does not impose any income tax on profits it considers capital gains, and would not impose any tax on either an English trust or its beneficiaries, whether [fol. 32] they were residents of the United States or the United Kingdom, it would, so the argument runs, defeat the manifest purposes of the Convention to deny the exemption here.[3] We must, it is therefore urged, ignore the

of United Kingdom tax and not resident in the United States for the purposes of United States tax." (Art. II(1)(g), 60 Stat. (Part 2) 1378. That this definition applies to the trust is clear. Art. II(3), 60 Stat. (Part 2) 1379, states that terms not defined in the Convention shall have the meaning given them by the laws of the country which is applying the treaty to a question of domestic taxation. Since the word "person" is not defined in the treaty, it is necessary to resort to United States law to determine whether or not a trust is a "person." Under United States law, as under British law, the term "person" encompasses a trust. Internal Revenue Code of 1954, §7701(a)(1), 26 U. S. C. §7701(a)(1); Harvard Law School, World Tax Series, Taxation in the United Kingdom ¶¶5/3.1, 5/3.4, pp. 125, 127 (1957). Since this trust is resident within the United States for purposes of United States tax, it cannot be considered a resident of the United Kingdom.

[3] For a discussion of United Kingdom taxation of capital gains, see note 4 *infra*.

United States rule that the trust is a separate entity, treat trust and beneficiary as one taxpayer, and allow as a deduction from the trust income the exemption granted the beneficiary by the Convention. In essence the contentions are threefold: that Article XIV was designed to achieve equality of tax treatment; that even though the parties did not explicitly provide for an exemption in this situation, the Convention must be read as if they did in order to further the objective of equality; and that this construction must be adopted, regardless of its impact on domestic tax policy.

As we are unable to find any explicit consideration of the issues thus raised in the language ~~or~~ background of the agreement, these contentions require a fundamental evaluation of the purposes and aims of the Convention. The basic aim of treaty interpretation is to ascertain the intent of the parties who have entered into agreement, in order to construe the document in a manner consistent with that intent. *Rocca* v. *Thompson*, 223 U. S. 317, 331-332; Restatement, The Foreign Relations Law of the United States §129 (Tent. Draft No. 3, 1959). And to give the specific words of a treaty a meaning consistent with the genuine shared expectations of the contracting parties, it is necessary to examine not only the language, but the entire context of agreement. We must therefore examine all available evidence of the shared expectations of the parties to this Convention in order to answer the interrelated questions whether Article XIV was designed to achieve equality of tax treatment, and whether alterations [fol. 33] of domestic tax law as are here proposed to realize such equality are themselves consistent with the intent of the contracting parties.

An examination of the full text of the Convention and the context of agreement indicates that, while one of the reasons Article XIV was included in the Convention was to achieve "equality" of tax treatment, imposition of a tax in the circumstances of this case would not be inconsistent with this objective. For the "equality" the parties strived for in this Article, as in similar provisions, was a limited one; they struck a rough bargain and were willing to tolerate marginal inequities of the sort involved in this case. While this dilutes the force of the taxpayer's argu-

ment, it alone might not require a denial of the exemption. But further principles must be considered. There is strong evidence that in the several Articles whose primary aim was to achieve substantial equality of tax treatment as between nationals of the contracting parties, the mutual concessions made were clearly delimited within the four corners of the instrument. Where it was necessary to make adjustments in domestic provisions in order to achieve the objectives of the Article, these were made explicitly. Thus to sanction free-wheeling adjustment of domestic provisions to achieve point-by-point equality would be to risk undoing the bargain reached by the two nations. Finally, the Convention did not aim at achieving "equality" in a vacuum; the adjustments made equalizing tax treatment were made to achieve broader objectives of the treaty. Denial of the exemption here, while admittedly resulting in some inequality of tax treatment, will not affect those primary purposes.

Although Article XIV on its face is a one-way concession by the United States, it was designed to and does render the tax treatment of United Kingdom residents realizing capital gains in the United States substantially equal to [fol. 34] that of the United Kingdom. As we have said, it is reciprocal because the United Kingdom does not tax those profits it classifies as capital gains. But it does not achieve complete equality. In some ways the provision is more beneficial to the United States, for it exempts the gains of only those United Kingdom residents who are not engaged in a trade or business in the United States, while as a result of the United Kingdom policy of not taxing capital gains, a United States resident will be free of United Kingdom tax, regardless of whether he engages in a trade or business. On the other hand, the Convention sanctions the imposition of United Kingdom taxes in some instances where, as a result of Article XIV, a United Kingdom resident would be free of United States tax. For in many instances the United Kingdom does impose its standard tax on transactions which are considered to be the sale or exchange of capital assets under United States law, and

in some cases this would result in "unequal" treatment.[4] For these reasons it cannot be said that, by including Article XIV in the Convention, the parties expected to establish wholly congruent tax treatment of capital gains realized by each other's residents.[5]

[fol. 35] Scrutiny of the manner in which this and similar Articles were drafted reinforces the conclusion that whatever "equality" the contracting parties desired to achieve was clearly defined in the Convention. These Articles were drafted with technical precision; no room was left for further adjustments of domestic law. Article VI, 60 Stat. (Part 2) 1381, provides a clear example. In order to equalize the treatment of dividends—a difficult task because of the great difference in United States and United Kingdom concepts of the nature of corporate profits—complex adjustments were made in the rates and manner of taxing of both countries. The United States lowered its rates, while the United Kingdom granted an exemption from surtax. This Article did not achieve a complete equivalence of treatment; the result of the adjustments was to guarantee that the total tax burden imposed by each nation would

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[4] It is commonly believed that Great Britain imposes no taxes on capital gains. This is true on a verbal level, and on a verbal level only. Comparative analysis of the two tax systems indicates that many functional transactions given capital-gains treatment in the United States are taxed as ordinary income in Great Britain. For example, gain on the sale of securities by an investment company is considered a capital gain in the United States and is taxed at the lower capital-gains rates. Internal Revenue Code of 1954, §§822, 832, 852. In the United Kingdom the same profits, far from being tax free, are treated as income and thus subject to the full standard tax. *Northern Assurance Co.* v. *Russell*, [1889] 2 T. C. 551 (U. K.). Other examples abound. Brudno & Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 Brit. Tax Rev. 26, 134, *passim*.

[5] Indeed, the Senate Committee which studied the Convention prior to ratification considered the possibility that, as a result of the disparity of capital-gain taxation between the countries, the United Kingdom resident would be at an advantage in some circumstances. Hearings on Executive D and E before a Subcommittee of the Committee on Foreign Relations of the United States Senate, 79th Cong., 1st Sess. 75 (1945). [Hereinafter cited as Hearings.]

be approximately the same. On close analysis Article XIV emerges as a similar technical adjustment. It is not a general exhortation to equality; it is addressed only to an exemption from United States tax, and is couched in the technical terminology of the Internal Revenue Code.[6] Despite possible inequities which might arise from *United Kingdom* taxation of United States residents' gains, no provision was made for relief from United Kingdom tax.[7] [fol. 36] The broad aim of the Convention, as with income tax treaties generally, was to facilitate commercial enterprise between the two countries.[8] Specifically, the Convention was designed to avoid double taxation and prevent fiscal evasion.[9] The prime target was double taxation, which, because of the high rates of income taxation then and now prevailing in the two nations, constituted what the Secretary of State called "an undesirable impediment to

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[6] The Convention was the result of a series of mutual concessions; there is evidence that Article XIV reflects a concession given by the United States in return for the counterconcession that the United Kingdom would co-operate in the exchange of tax information. Hearings, p. 62. Since the British policy of secrecy had stymied a prior attempt to negotiate a tax convention in 1937, *id.* at 56, it is clear that the bargain made was an important one.

[7] It is true, as the taxpayer points out, that some of the differences between the two systems will be further equalized by the application of Article III(2), 60 Stat. (Part 2) 1380, which exempts United States enterprises not engaged in trade or business in the United Kingdom from United Kingdom tax on industrial or commercial profits. Instead of weakening our conclusion, however, this section reinfo es it. Since Article III(2) applies only to "enterprises," it does not create the across-the-board equality urged here. See Article II(1)(j), 60 Stat. (Part 2) 1379. *Cf.* Ehrenzweig & Koch, Income Tax Treaties §211, p. 206 (1949). And the fact that Article III(2) will operate to eliminate some of the possible inequities created by Article XIV buttresses our conclusion that the latter Article was carefully drafted, and overrides domestic law only as explicitly specified.

[8] Memorandum prepared for the Committee on Foreign Relations, United States Senate, Relative to Convention with Great Britain and Northern Ireland with Respect to Taxes on Income. Printed at Hearings, pp. 23, 27.

[9] 60 Stat. (Part 2) 1377.

international trade."[10] A primary motivation for inclusion of provisions equalizing tax treatment such as Article XIV was reduction of tax barriers to the free movement of individuals for commercial purposes.[11] And exemption here is unnecessary to achieve these ends. There can be no double taxation, since neither the beneficiary[12] nor the ultimate recipients of the corpus[13] will be taxable in the [fol. 37] United Kingdom on these gains. Thus we cannot see that such an exemption would affect commercial intercourse between the two countries in any significant manner.

With this background we must examine the taxpayer's argument that "exempt" as used in Article XIV must be read as signifying a "release from economic burden." Of course the first difficulty with this argument is that it is wholly unclear that the entire economic burden of the tax will fall on United Kingdom residents. Since the tax constitutes a charge on the corpus, it will affect the present beneficiary only slightly by reducing the income; and it is difficult to say now that when the ultimate recipients of the corpus take, they will all be residents of the United Kingdom. As we have indicated, adoption of such a broad interpretation of Article XIV is unnecessary to further the objectives of the Convention, and is inconsistent with the manner in which this provision was drafted. In these circumstances we can see no reason to override the technical language of the Convention which, in conjunction with the Internal Revenue Code, as incorporated by Article II(3), recognizes the trust as a separate taxable entity.

This is the interpretation of the Treasury Department taken in its original regulations issued in conjunction with

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[10] Hearings, p. 2. See also *id.* at 42.

[11] *Id.* at 27.

[12] See *Jones* v. *Leeming*, [1930] A. C. 415; Brudno & Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 Brit. Tax Rev. 26, 42.

[13] See *Trustees of the Will of Brodie* v. *Commissioners of Inland Revenue*, 17 T. C. 432, 438 (K. B. 1933) (dictum). *Cf.* Harvard Law School, World Tax Series, Taxation in the United Kingdom ¶10/7.2, pp. 307-308 (1957).

the Convention. These regulations took the position that a nonresident alien beneficiary of a domestic trust was exempt from tax on capital gains accrued by the trust only in so far as the gains are includable in his distributive share of the trust's income. T. D. 5569, 1947-2 Cum. Bull. 100, §7.519(c). A similar position recognizing that the trust is a separate taxable entity for the purpose of determining treaty exemptions has been taken in the interpretation of all our tax conventions.[14] We hold that this [fol. 38] is the correct interpretation of Article XIV of this Convention.

In so holding, we are not unmindful of the decision of the Ninth Circuit in *American Trust Co. v. Smyth*, 9 Cir., 247 F. 2d 149, which held under similar circumstances that Article XIV created an exemption. This opinion, which was followed by the court below in this case, adopts the "economic burden" analysis.[15] For the reasons advanced above we believe that decision to be erroneous, and accept instead the reasoning of Judge Carter in the decision there reversed, *American Trust Co. v. Smyth*, D. C. N. D. Cal., 141 F. Supp. 414. See in accord with the view we are taking

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[14] E.g., Australia, T. D. 6108, Cum. Bull. 1954-2, 614, §501.10; Austria, T. D. 6322, Cum. Bull. 1954-1, 132, §516.8; Belgium, T. D. 6160, Cum. Bull. 1956-1, 815, §504.119; France, T. D. 6273, Cum. Bull. 1956-1, 837, §514.7; Switzerland, T. D. 6149, I. R. B. 1957-19, 42.

[15] In *American Trust Co. v. Smyth*, 9 Cir., 247 F. 2d 149, the Ninth Circuit also laid some stress on the fact that this Convention, unlike many United States Conventions with other countries, did not have a "savings clause." This clause allows the United States to impose a tax on all of its residents or citizens or domestic corporations "as though this convention had not come into effect." E.g., Art. XIX (1) of the Convention with Norway, 62 Stat. (Part 2) 1764. Although the United Kingdom treaty does not have a clause precisely to this effect, the same limiting function is played by the definition of "resident of the United Kingdom" in Article II (1) (g), 60 Stat. (Part 2) 1378, which excludes citizens of the United States, United States corporations, and persons resident in the United States for the purpose of United States tax. Since only residents of the United Kingdom are granted any exemption from United States tax under the treaty, compare Articles III, VI, VII, VIII, IX, XI, XII, and XIV, this provision acts as a savings clause. Thus we ascribe no significance to the absence of such a clause from the United Kingdom Convention.

the Note, 71 Harv. L. Rev. 1163 (1958), though contra are Note, 9 Stan. L. Rev. 610 (1957), and Note, 33 N. Y. U. L. Rev. 233 (1958).

Reversed and remanded for the entry of judgment for the defendant.

[fol. 39] IN UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Present: Hon. Charles E. Clark, Hon. Henry J. Friendly, Hon. Irving R. Kaufman, Circuit Judges.

ANDRE MAXIMOV, as Trustee for the benefit of H. Robin Fedden u/a Dated 10/24/47, Plaintiff-Appellee,

v.

UNITED STATES OF AMERICA, Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

JUDGMENT—February 14, 1962

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for the entry of judgment for the defendant-appellant in accordance with the opinion of this court.

A. Daniel Fusaro, Clerk.

[fol. 40] [File endorsement omitted]

[fol. 41] Clerk's Certificate to foregoing transcript (omitted in printing).

[fol. 42] SUPREME COURT OF THE UNITED STATES

No. —October Term, 1961

ANDRE MAXIMOV, as Trustee, etc., Petitioner,

vs.

UNITED STATES.

ORDER EXTENDING TIME TO FILE PETITION FOR WRIT OF CERTIORARI—May 8, 1962

Upon Consideration of the application of counsel for petitioner,

It Is Ordered that the time for filing petition for writ of certiorari in the above-entitled cause be, and the same is hereby, extended to and including July 14th, 1962.

Dated this 8th day of May, 1962.

John M. Harlan, Associate Justice of the Supreme Court of the United States.

[fol. 43] SUPREME COURT OF THE UNITED STATES

No. 240—October Term, 1962

ANDRE MAXIMOV, etc., Petitioner,

vs.

UNITED STATES.

ORDER ALLOWING CERTIORARI—October 8, 1962

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary calendar.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Goldberg took no part in the consideration or decision of this petition.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 240

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

D. NELSON ADAMS,
Counsel for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

JOHN A. REED

Of Counsel:

DAVIS POLK WARDWELL SUNDERLAND & KIENDL,

HILL BETTS YAMAOKA FREEHILL & LONGCOPE.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No.

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBINS FEDDEN, u/a dated 10/24/47,
Petitioner,

against

THE UNITED STATES OF AMERICA,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully asks that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit reversing the judgment of the United States District Court with directions to enter judgment for the defendant.

Opinion Below.

The opinion of the Court of Appeals is reported in 299 F. 2d 565 and is printed in the Appendix (A-1)*.

* The designation "(A)" refers to the Appendix hereto and the designation "(R)" refers to the "Appendix B to Brief for Appellant" in the Court of Appeals.

Statement of Jurisdiction.

The judgment of the Court of Appeals was entered on February 14, 1962, and the jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Question Presented.

The question is whether capital gains realized by a trustee of a United States trust, when held for future distribution to citizens and residents of the United Kingdom, are exempt from Federal income tax under the Income Tax Convention between the United States and the the United Kingdom as implemented by Section 894 of our Internal Revenue Code of 1954 and by Section 22(b)(7) of our Internal Revenue Code of 1939.

Treaties, Statutes and Regulations Involved.

Section 894 of our Internal Revenue Code of 1954 provides broadly:

> "Sec. 894. Income Exempt Under Treaty.
>
> Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle."

Section 22(b)(7) of the Internal Revenue Code of 1939 was to substantially the same effect.

Since 1936 when Section 22(b)(7) was first enacted, it has been the declared policy of Congress to give full recognition to treaty provisions in case of any conflict between the treaty and our domestic revenue laws. Section 22(b)(7) was limited to exemptions in treaties, but in 1942 Congress broadened the policy so that it embraced any treaty obligation. Thus in the Revenue Act of 1942 making certain

amendments to the 1939 Code, Section 109 entitled "Treaty Obligations" provided:

> "No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States."

And again in enacting the Internal Revenue Code of 1954, Congress expressly provided in Section 7852(d):

> "(d) Treaty Obligations. — No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title."

The exemption here claimed arises under the Income Tax Convention with the United Kingdom. In particular, Article XIV provides:

> "A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets."

Other pertinent portions of the Convention, which portions have remained unchanged since the Convention became effective, are reproduced in the Appendix hereto (A-13-19). We there print also the other material parts of the Internal Revenue Codes of 1954 and 1939 (A-20-25).

Treasury Decision 5569 comprises the Commissioner's regulations applicable to the Convention. 1947-2 Cum. Bull. 100, 109. Section 7.519, subparagraph (c), of T. D. 5569 provides:

> "(c) *Beneficiaries of an Estate or Trust.* — A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, pro-

vided in Articles VI, VII, VIII, IX and XIV of the convention with respect to dividends, interest, royalties, natural resource royalties, rentals from real property and capital gains to the extent such item or items are included in his distributive share of income of such estate or trust if he is taxable in the United Kingdom on such income and is not engaged in trade or business in the United States through a permanent establishment."

Statement of the Case.

The petitioner is the duly qualified successor trustee of a certain *inter vivos* trust created by H. Robbin Fedden (hereinafter sometimes referred to as the grantor) (R 3b, 4b, 13b-21b). During 1954 and 1955 the trustee sold part of the property constituting the corpus of the trust at a profit (R 3b, 4b). The trustee duly filed Federal income tax returns, reporting the sale and the amount of profit and paid the District Director of Internal Revenue capital gain taxes of $53.10 for 1954 and $1,316.32 for 1955 (R 3b). Thereafter, a claim for refund was filed with the District Director of Internal Revenue, asserting that such taxes were erroneously and illegally collected (R 3b). The claim for refund was denied in full (R 3b) and this suit followed (R 3b, 4b), the jurisdiction of the District Court having been invoked because this is a suit for refund of Federal income taxes.

Throughout 1954 and 1955 all the income beneficiaries of the trust and all the remaindermen of the trust were residents of the United Kingdom of Great Britain and Northern Ireland and were not engaged in trade or business in the United States (R 22b, 23b).

The Court below held that capital gains realized by the trustee of a United States trust when currently distributable are exempt under the United Kingdom Convention, but that the capital gains when held for future distribution are not exempt.

Reasons for Allowance of the Writ.

The Decision of the Court of Appeals Conflicts with a Decision of the Court of Appeals for the Ninth Circuit.

In *American Trust Company* v. *Smyth*, 247 F. 2d 149 (9th Cir. 1957), the facts were directly in point with the present case. The Court of Appeals for the Ninth Circuit held that capital gains realized in 1946 by a trustee of a United States trust when held for future distribution to citizens and residents of the United Kingdom are exempt from Federal income tax under the United Kingdom Convention.

It is evident from its opinion that the Court below recognized that its decision was in conflict with this decision of the Court of Appeals for the Ninth Circuit. It stated (A-10, 11):

> "In so holding, we are not unmindful of the decision of the Ninth Circuit in *American Trust Co.* v. *Smyth*, 9 Cir., 247 F. 2d 149, which held under similar circumstances that Article XIV created an exemption. * * * For the reasons advanced above we believe that decision to be erroneous, * * *."

The Importance of the Question Presented.

The question presented is involved in many cases now pending before the Internal Revenue Service and the courts and as the opinion below further pointed out, objective thinking on the subject is also at variance. Said the Court below in conclusion (A-11):

> "See in accord with the view we are taking, the Note, 71 Harv. L. Rev. 1163 (1958), though contra are Note, 9 Stan. L. Rev. 610 (1957), and Note 33 N. Y. U. L. Rev. 233 (1958)."

In view of the present uncertain state of the law, trustees of American trusts, the beneficiaries of which are British, have a fiduciary duty to contest any liability for the

capital gains tax unless and until an ultimate judicial determination of the question is obtained.

An international treaty between two sovereign nations is a document which may not be lightly set aside. Yet this in effect is what the Court below has done.

In the case here involved, the Congress has expressly implemented any exemption accorded in our income tax conventions with other nations, for Section 894 of our Internal Revenue Code of 1954 and the corresponding Section 22(b)(7) of our Revenue Code of 1939 provide broadly that "Income of any kind" shall be exempt from taxation "to the extent required by any treaty".

Throughout the Convention the primary objective was the accomplishment of full reciprocity and equality of tax treatment between the nationals of the contracting parties. In a reverse but like situation, the United Kingdom did not impose a tax on capital gains from the sale of property in trust. Article XIV was intended to put the nationals of both parties on the same footing. Unless Article XIV is given the broad interpretation for which we contend, it will be the one article which does not accomplish reciprocity.

Conclusion.

In summary, this case presents a decision by the Court of Appeals that is in conflict with a decision of another Court of Appeals as to the interpretation of a tax treaty and there are many cases now pending in the Internal Revenue Service and in the courts awaiting resolution of this conflict. Under the circumstances the obvious importance of the question presented herein calls for an exercise of this Court's power of review.

Respectfully submitted,

D. Nelson Adams,
Counsel for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

John A. Reed

Of Counsel:

Davis Polk Wardwell
Sunderland & Kiendl,

Hill Betts Yamaoka
Freehill & Longcope.

APPENDIX A

UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 118—September Term, 1961.

(Argued November 30, 1961 Decided February 14, 1962.)

Docket No. 26984

Andre Maximov, as Trustee for the benefit of H. Robbin Fedden u/a dated 10/24/47,

Plaintiff-Appellee,

—v.—

United States of America,

Defendant-Appellant.

Before:

Clark, Friendly and Kaufman,

Circuit Judges.

Appeal from the United States District Court for the Southern District of New York, Lloyd F. MacMahon, *Judge*.

The United States of America appeals from the grant of a refund of income taxes for 1954 and 1955 on an American *inter vivos* trust as being exempt therefrom under Article XIV of the Income Tax Convention between the United

States and the United Kingdom. Reversed for judgment for defendant.

RICHARD J. MEDALIE, Atty., Dept. of Justice, Washington, D. C. (Louis F. Oberdorfer, Asst. Atty. Gen., Meyer Rothwacks, Atty., Dept. of Justice, Washington, D. C., and Robert M. Morgenthau, U. S. Atty., S. D. N. Y., New York City, on the brief), *for defendant-appellant.*

WILLIAM F. SUGLIA, of Hill, Betts, Yamaoka, Freehill & Longcope, New York City (John F. Lang, of Hill, Betts, Yamaoka, Freehill & Longcope, New York City, on the brief), *for plaintiff-appellee.*

CLARK, *Circuit Judge*:

The taxpayer, Andre Maximov, is the successor trustee of an *inter vivos* trust created in 1947, under the laws of Connecticut, by H. Robbin Fedden. Under the terms of the trust instrument all income is to be paid to the grantor during his life; on his death the income is payable to his wife if she survives him and is still married to him. On her death if she qualifies for this life estate, or on the grantor's if she does not, the entire principal of the trust is to be paid to the surviving issue of the grantor in equal shares, *per stirpes,* with limitations not here relevant. At the time the trust was created, and at all times thereafter, the grantor-beneficiary and his wife and children have resided in England.

During its taxable years 1954 and 1955 the trust realized net long-term capital gains from the sale of securities, resulting in tax liabilities of $53.10 and $1,316.32 respec-

tively. Under Connecticut law these gains were retained as corpus.[1] Maximov, as trustee, filed federal fiduciary income tax returns for 1954 and 1955 with the District Director of Internal Revenue for Lower Manhattan reporting these gains, and paid the appropriate tax. Several years later, however, he filed a claim for refund of the tax on these two capital transactions, contending that as the gains were realized by a trust whose beneficiaries reside in the United Kingdom, they are exempt from United States tax under Article XIV of the Income Tax Convention between the United States and the United Kingdom, 60 Stat. (Part 2) 1377.

Under United States tax law the trust is treated as a separate taxable entity. *Freuler* v. *Helvering*, 291 U. S. 35. Income received by the trust and not distributable to the beneficiaries, or not includable in the trust's distributable net income, is taxable to the trust. As the income involved here was neither distributable nor part of the distributable net income of the trust, Internal Revenue Code of 1954, § 643(c), these gains are considered the income of the trust, taxable to it, and are not the income of the life tenant or the remaindermen.

The Convention grants an exemption from United States tax on gains from the sale or exchange of capital assets to residents of the United Kingdom not engaged in a trade or business within the United States. Article XIV, 60 Stat. (Part 2) 1384. Were the trust a "resident" of the United Kingdom, as such a resident is defined in the Convention, or were this income includable in the gross income of the grantor-beneficiary, who is a resident of the United Kingdom and not engaged in a trade or business here, the exemption would be clearly applicable. See T. D. 5569, 1947-2 Cum. Bull. 100, § 7.519(c). The difficulty which this case presents is that the trust is not a United Kingdom resident

[1] Conn. Gen. Stat. Ann. § 45-112 (1958)

and the income here is treated in United States law as that of the trust.[2] Since the exemption of Article XIV explicitly applies only to *residents* of the United Kingdom, the taxpayer's claim can be sustained only if we disregard the separate tax treatment accorded trusts by United States law.

This is precisely what the taxpayer urges us to do. He asserts that the word "exempt" in Article XIV should be read as signifying a "release from economic burden," and that as the economic burden of the tax falls here on United Kingdom residents—the grantor-beneficiary and his family—the exemption must be read as applying in this case. In support of this contention the taxpayer maintains that one purpose of the tax convention was to achieve reciprocity of tax treatment for the nationals of the contracting parties. Thus, he argues, the aim of Article XIV was to secure for United Kingdom residents realizing capital gains in the United States precisely the same treatment that a United States resident would be given on similar gains realized within the tax jurisdiction of the United Kingdom. Since the United Kingdom does not impose any income tax on profits it considers capital gains, and would not impose any tax on either an English trust or its bene-

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[2] A resident of the United Kingdom is defined as "any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax." Art. II(1)(g), 60 Stat. (Part 2) 1378. That this definition applies to the trust is clear. Art. II(3), 60 Stat. (Part 2) 1379, states that terms not defined in the Convention shall have the meaning given them by the laws of the country which is applying the treaty to a question of domestic taxation. Since the word "person" is not defined in the treaty, it is necessary to resort to United States law to determine whether or not a trust is a "person." Under United States law, as under British law, the term "person" encompasses a trust. Internal Revenue Code of 1954, § 7701(a)(1), 26 U. S. C. § 7701(a)(1); Harvard Law School, World Tax Series, Taxation in the United Kingdom, ¶¶ 5/3.1, 5/3.4, pp. 125, 127 (1957). Since this trust is resident within the United States for purposes of United States tax, it cannot be considered a resident of the United Kingdom.

ficiaries, whether they were residents of the United States or the United Kingdom, it would, so the argument runs, defeat the manifest purposes of the Convention to deny the exemption here.[3] We must, it is therefore urged, ignore the United States rule that the trust is a separate entity, treat trust and beneficiary as one taxpayer, and allow as a deduction from the trust income the exemption granted the beneficiary by the Convention. In essence the contentions are threefold: that Article XIV was designed to achieve equality of tax treatment; that even though the parties did not explicitly provide for an exemption in this situation, the Convention must be read as if they did in order to further the objective of equality; and that this construction must be adopted, regardless of its impact on domestic tax policy.

As we are unable to find any explicit consideration of the issues thus raised in the language or background of the agreement, these contentions require a fundamental evaluation of the purposes and aims of the Convention. The basic aim of treaty interpretation is to ascertain the intent of the parties who have entered into agreement, in order to construe the document in a manner consistent with that intent. *Rocca* v. *Thompson*, 223 U. S. 317, 331-332; Restatement, The Foreign Relations Law of the United States §129 (Tent. Draft No. 3, 1959). And to give the specific words of a treaty a meaning consistent with the genuine shared expectations of the contracting parties, it is necessary to examine not only the language, but the entire context of agreement. We must therefore examine all available evidence of the shared expectations of the parties to the Convention in order to answer the interrelated questions whether Article XIV was designed to achieve equality of tax treatment, and whether alterations of domestic tax law as are here proposed to realize such

[3] For a discussion of United Kingdom taxation of capital gains, see note 4 *infra*.

equality are themselves consistent with the intent of the contracting parties.

An examination of the full text of the Convention and the context of agreement indicates that, while one of the reasons Article XIV was included in the Convention was to achieve "equality" of tax treatment, imposition of a tax in the circumstances of this case would not be inconsistent with this objective. For the "equality" the parties strived for in this Article, as in similar provisions, was a limited one; they struck a rough bargain and were willing to tolerate marginal inequities of the sort involved in this case. While this dilutes the force of the taxpayer's argument, it alone might not require a denial of the exemption. But further principles must be considered. There is strong evidence that in the several Articles whose primary aim was to achieve substantial equality of tax treatment as between nationals of the contracting parties, the mutual concessions made were clearly delimited within the four corners of the instrument. Where it was necessary to make adjustments in domestic provisions in order to achieve the objectives of the Article, these were made explicitly. Thus to sanction free-wheeling adjustment of domestic provisions to achieve point-by-point equality would be to risk undoing the bargain reached by the two nations. Finally, the Convention did not aim at achieving "equality" in a vacuum; the adjustments made equalizing tax treatment were made to achieve broader objectives of the treaty. Denial of the exemption here, while admittedly resulting in some inequality of tax treatment, will not affect those primary purposes.

Although Article XIV on its face is a one-way concession by the United States, it was designed to and does render the tax treatment of United Kingdom residents realizing capital gains in the United States substantially equal to that of the United Kingdom. As we have said, it is reciprocal because the United Kingdom does not tax those prof-

its it classifies as capital gains. But it does not achieve complete equality. In some ways the provision is more beneficial to the United States, for it exempts the gains of only those United Kingdom residents who are not engaged in a trade or business in the United States, while as a result of the United Kingdom policy of not taxing capital gains, a United States resident will be free of United Kingdom tax, regardless of whether he engages in a trade or business. On the other hand, the Convention sanctions the imposition of United Kingdom taxes in some instances where, as a result of Article XIV, a United Kingdom resident would be free of United States tax. For in many instances the United Kingdom does impose its standard tax on transactions which are considered to be the sale or exchange of capital assets under United States law, and in some cases this would result in "unequal" treatment.[4] For these reasons it cannot be said that, by including Article XIV in the Convention, the parties expected to establish wholly congruent tax treatment of capital gains realized by each other's residents.[5]

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[4] It is commonly believed that Great Britain imposes no taxes on capital gains. This is true on a verbal level, and on a verbal level only. Comparative analysis of the two tax systems indicates that many functional transactions given capital-gains treatment in the United States are taxed as ordinary income in Great Britain. For example, gain on the sale of securities by an investment company is considered a capital gain in the United States and is taxed at the lower capital-gains rates. Internal Revenue Code of 1954, §§ 822, 832, 852. In the United Kingdom the same profits, far from being tax free, are treated as income and thus subject to the full standard tax. *Northern Assurance Co.* v. *Russell*, [1889] 2 T. C. 551 (U. K.). Other examples abound. Brudno & Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 Brit. Tax Rev. 26, 134, *passim*.

[5] Indeed, the Senate Committee which studied the Convention prior to ratification considered the possibility that, as a result of the disparity of capital-gain taxation between the countries, the United Kingdom resident would be at an advantage in some circumstances. Hearings on Executive D and E before a Subcommittee of the Committee on Foreign Relations of the United States Senate, 79th Cong., 1st Sess. 75 (1945). [Hereinafter cited as Hearings.]

Scrutiny of the manner in which this and similar Articles were drafted reinforces the conclusion that whatever "equality" the contracting parties desired to achieve was clearly defined in the Convention. These Articles were drafted with technical precision; no room was left for further adjustments of domestic law. Article VI, 60 Stat. (Part 2) 1381, provides a clear example. In order to equalize the treatment of dividends—a difficult task because of the great difference in United States and United Kingdom concepts of the nature of corporate profits—complex adjustments were made in the rates and manner of taxing of both countries. The United States lowered its rates, while the United Kingdom granted an exemption from surtax. This Article did not achieve a complete equivalence of treatment; the result of the adjustments was to guarantee that the total tax burden imposed by each nation would be approximately the same. On close analysis Article XIV emerges as a similar technical adjustment. It is not a general exhortation to equality; it is addressed only to an exemption from United States tax, and is couched in the technical terminology of the Internal Revenue Code.[6] Despite possible inequities which might arise from *United Kingdom* taxation of United States residents' gains, no provision was made for relief from United Kingdom tax.[7]

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[6] The Convention was the result of a series of mutual concessions; there is evidence that Article XIV reflects a concession given by the United States in return for the counterconcession that the United Kingdom would co-operate in the exchange of tax information. Hearings, p. 62. Since the British policy of secrecy had stymied a prior attempt to negotiate a tax convention in 1937, *id.* at 56, it is clear that the bargain made was an important one.

[7] It is true, as the taxpayer points out, that some of the differences between the two systems will be further equalized by the application of Article III(2), 60 Stat. (Part 2) 1380, which exempts United States enterprises not engaged in trade or business in the United Kingdom from United Kingdom tax on industrial or commercial profits. Instead of weakening our conclusion, however, this section reinforces it. Since Article III(2) applies only to "enterprises," it does not create the across-the-board equality

The broad aim of the Convention, as with income tax treaties generally, was to facilitate commercial enterprise between the two countries.[8] Specifically, the Convention was designed to avoid double taxation and prevent fiscal evasion.[9] The prime target was double taxation, which, because of the high rates of income taxation then and now prevailing in the two nations, constituted what the Secretary of State called "an undesirable impediment to international trade."[10] A primary motivation for inclusion of provisions equalizing tax treatment such as Article XIV was reduction of tax barriers to the free movement of individuals for commercial purposes.[11] And exemption here is unnecessary to achieve these ends. There can be no double taxation, since neither the beneficiary[12] nor the ultimate recipients of the corpus[13] will be taxable in the United Kingdom on these gains. Thus we cannot see that such an exemption would affect commercial intercourse between the two countries in any significant manner.

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urged here. See Article II(1)(j), 60 Stat. (Part 2) 1379. *Cf.* Ehrenzweig & Koch, Income Tax Treaties § 211, p. 206 (1949). And the fact that Article III(2) will operate to eliminate some of the possible inequities created by Article XIV buttresses our conclusion that the latter Article was carefully drafted, and overrides domestic law only as explicitly specified.

[8] Memorandum prepared for the Committee on Foreign Relations, United States Senate, Relative to Convention with Great Britain and Northern Ireland with Respect to Taxes on Income. Printed at Hearings, pp. 23, 27.

[9] 60 Stat. (Part 2) 1377.

[10] Hearings, p. 2. See also *id.* at 42.

[11] *Id.* at 27.

[12] See *Jones* v. *Leeming*, [1930] A. C. 415; Brudno & Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 Brit. Tax Rev. 26, 42.

[13] *See Trustees of the Will of Brodie* v. *Commissioners of Inland Revenue*, 17 T. C. 432, 438 (K. B. 1933) (dictum). *Cf.* Harvard Law School, World Tax Series, Taxation in the United Kingdom ¶10/7.2, pp. 307-308 (1957).

With this background we must examine the taxpayer's argument that "exempt" as used in Article XIV must be read as signifying a "release from economic burden." Of course the *first* difficulty with this argument is that it is wholly unclear that the entire economic burden of the tax will fall on United Kingdom residents. Since the tax constitutes a charge on the corpus, it will affect the present beneficiary only slightly by reducing the income; and it is difficult to say now that when the ultimate recipients of the corpus take, they will all be residents of the United Kingdom. As we have indicated, adoption of such a broad interpretation of Article XIV is unnecessary to further the objectives of the Convention, and is inconsistent with the manner in which this provision was drafted. In these circumstances we can see no reason to override the technical language of the Convention which, in conjunction with the Internal Revenue Code, as incorporated by Article II(3), recognizes the trust as a separate taxable entity.

This is the interpretation of the Treasury Department taken in its original regulations issued in conjunction with the Convention. These regulations took the position that a nonresident alien beneficiary of a domestic trust was exempt from tax on capital gains accrued by the trust only in so far as the gains are includable in his distributive share of the trust's income. T. D. 5569, 1947-2 Cum. Bull. 100, § 7.519(c). A similar position recognizing that the trust is a separate taxable entity for the purpose of determining treaty exemptions has been taken in the interpretation of all our tax conventions.[14] We hold that this is the correct interpretation of Article XIV of this Convention.

In so holding, we are not unmindful of the decision of

[14] E.g., Australia, T. D. 6108, Cum. Bull. 1954-2, 614, § 501.10; Austria, T. D. 6322, Cum. Bull. 1954-1, 132, § 516.8; Belgium, T. D. 6160, Cum. Bull. 1956-1, 815, § 504.119; France, T. D. 6273, Cum. Bull. 1956-1, 837, § 514.7; Switzerland, T. D. 6149, I. R. B. 1957-19, 42.

the Ninth Circuit in *American Trust Co.* v. *Smyth*, 9 Cir., 247 F. 2d 149, which held under similar circumstances that Article XIV created an exemption. This opinion, which was followed by the court below in this case, adopts the "economic burden" analysis.[15] For the reasons advanced above we believe that decision to be erroneous, and accept instead the reasoning of Judge Carter in the decision there reversed, *American Trust Co.* v. *Smyth*, D. C. N. D. Cal., 141 F. Supp. 414. See in accord with the view we are taking the Note, 71 Harv. L. Rev. 1163 (1958), though contra are Note, 9 Stan. L. Rev. 610 (1957), and Note, 33 N. Y. U. L. Rev. 233 (1958).

Reversed and remanded for the entry of judgment for the defendant.

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[15] In *American Trust Co.* v. *Smyth*, 9 Cir., 247 F. 2d 149, the Ninth Circuit also laid some stress on the fact that this Convention, unlike many United States Conventions with other countries, did not have a "savings clause." This clause allows the United States to impose a tax on all of its residents or citizens or domestic corporations "as though this convention had not come into effect." E.g., Art. XIX(1) of the Convention with Norway, 62 Stat. (Part 2) 1764. Although the United Kingdom treaty does not have a clause precisely to this effect, the same limiting function is played by the definition of "resident of the United Kingdom" in Article II(1)(g), 60 Stat. (Part 2) 1378, which excludes citizens of the United States, United States corporations, and persons resident in the United States for the purpose of United States tax. Since only residents of the United Kingdom are granted any exemption from United States tax under the treaty, compare Articles III, VI, VII, VIII, IX, XI, XII, and XIV, this provision acts as a savings clause. Thus we ascribe no significance to the absence of such a clause from the United Kingdom Convention.

UNITED STATES COURT OF APPEALS

For the Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the fourteenth day of February one thousand nine hundred and sixty-two.

Present—Hon. Charles E. Clark,
Hon. Henry J. Friendly,
Hon. Irving R. Kaufman,
Circuit Judges.

Andre Maximov, as Trustee for the benefit of H. Robin Fedden u/a Dated 10/24/47,
Plaintiff-Appellee,

vs.

United States of America,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for the entry of judgment for the defendant-appellant in accordance with the opinion of this court.

A. Daniel Fusaro,
Clerk.

A true copy,
A. Daniel Fusaro,
Clerk.

(Seal)

THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (60 STAT. (PART 2) 1377)

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

WHEREAS a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed by their respective Plenipotentiaries at Washington on April 16, 1945;

AND WHEREAS a supplementary protocol modifying in certain respects the said convention was signed by the respective Plenipotentiaries of the United States of America and the United Kingdom of Great Britain and Northern Ireland at Washington on June 6, 1946;

AND WHEREAS the originals of the said convention and the said supplementary protocol are word for word as follows:

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland,

Desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have appointed for that purpose as their Plenipotentiaries:

The Government of the United States of America:

Mr. Edward R. Stettinius, Jr., Secretary of State, and

The Government of the United Kingdom of Great Britain and Northern Ireland:

The Right Honorable the Earl of Halifax, K.G., Ambassador Extraordinary and Plenipotentiary in Washington,

Who, having exhibited their respective full powers, found in good and due form, have agreed as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

(a) In the United States of America:

The Federal income taxes, including surtaxes and excess profits taxes (hereinafter referred to as United States tax).

(b) In the United Kingdom of Great Britain and Northern Ireland:

The income tax (including surtax), the excess profits tax and the national defense contribution (hereinafter referred to as United Kingdom tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequently to the date of signature of the present Convention. * * *

ARTICLE II

(1) In the present Convention, unless the context otherwise requires:

* * * * *

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A

corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the

other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

(2) For the purposes of Articles VI, VII, VIII, IX and XIV a resident of the United Kingdom shall not be deemed to be engaged in trade or business in the United States in any taxable year unless such resident has a permanent establishment situated therein in such taxable year. The same principle shall be applied, *mutatis mutandis*, by the United Kingdom in the case of a resident of the United States.

(3) In the application of the provisions of the present Convention by one of the Contracting Parties any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the present Convention.

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ARTICLE VI

(1) The rate of United States tax on dividends derived from a United States coproration by a resident of the United Kingdom who is subject to United Kingdom tax on such dividends and not engaged in trade or business in the United States shall not exceed 15 per cent: * * *

(2) Dividends derived from sources within the United Kingdom by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such dividends, and (c) not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom surtax.

* * * * *

ARTICLE VII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such interest and not engaged in trade or business in the United States, shall be exempt from United States tax; * * *

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United Kingdom by a resident of the United States who is subject to United States tax on such interest and not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom tax; * * *

* * * * *

ARTICLE XIII

(1) Subject to section 131 of the United States Internal Revenue Code * * *, United Kingdom tax shall be allowed as a credit against United States tax. * * *

(2) Subject to such provisions (which shall not affect the general principle hereof) as may be enacted in the United Kingdom, United States tax payable in respect of income from sources within the United States shall be allowed as a credit against any United Kingdom tax payable in respect of that income.

* * * * *

ARTICLE XIV

A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

ARTICLE XXIII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon exchange of ratifications, the present Convention shall have effect

(a) as respects United States tax, for the taxable years beginning on or after the first day of January 1945;

* * * * *

ARTICLE XXIV

(1) The present Convention shall continue in effect indefinitely but either of the Contracting Parties may, on or before the 30th day of June in any year after the year 1946, give to the other Contracting Party, through diplomatic channels, notice of termination * * *

In Witness Whereof the above-mentioned Plenipotentiaries have signed the present Convention and have affixed thereto their seals.

* * * * *

Now, Therefore, be it known that I, Harry S. Truman, President of the United States of America, do hereby proclaim and make public the said convention * * * to the end that the same and every article and clause thereof may be observed and fulfilled with good faith by the United States of America, and by the citizens of the United States of America, and all other persons subject to the jurisdiction thereof, the said convention * * * being deemed to have effect as provided in Article XXIII of the said convention, as aforesaid.

Done at the city of Washington this thirtieth day of July in the year of our Lord one thousand nine hundred forty-six and of the Independence of the United States of America the one hundred seventy-first.

Harry S. Truman

By the President:

Dean Acheson
Acting Secretary of State

OTHER MATERIAL PARTS OF OUR INTERNAL REVENUE CODE OF 1954

SEC. 641. IMPOSITION OF TAX.

(a) *Application of tax.*—The taxes imposed by this chapter on individuals shall apply to the taxable income of estates or of any kind of property held in trust, including—

(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and Payment.*—The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary.

(26 U.S.C. 1958 ed., Sec. 641)

SEC. 643. DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D.

(a) *Distributable Net Income.*—For purposes of this part, the term "distributable net income" means, with

respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

* * * *

(3) *Capital Gains and Losses.*—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year * * *.

* * * *

(26 U.S.C. 1958 ed., Sec. 643)

SEC. 651. DEDUCTION FOR TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

(a) *Deduction.*—In the case of any trust the terms of which—

(1) provide that all of its income is required to be distributed currently, and

(2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 642 (c) (relating to deduction for charitable, etc., purposes),

there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently. This section shall not apply in any taxable year in which the trust distributes amounts other than amounts of income described in paragraph (1).

* * * *

(26 U.S.C. 1958 ed., Sec. 651)

SEC. 652. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

(a) *Inclusion.*—Subject to subsection (b) the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. * * *

* * * *

(26 U.S.C. 1958 ed., Sec. 652)

SEC. 661. DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) *Deduction.*—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

* * * *

(26 U.S.C. 1958 ed., Sec. 661)

Sec. 662. Inclusion of Amounts in Gross Income of Beneficiaries of Estates and Trusts Accumulating Income or Distributing Corpus.

(a) *Inclusion.*—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) *Amounts Required to be Distributed Currently.*—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. * * *

(2) *Other Amounts Distributed.*—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. * * *

* * * *

(26 U.S.C. 1958 ed., Sec. 662)

CORRESPONDING PARTS OF SECTIONS 161 AND 162 OF OUR INTERNAL REVENUE CODE OF 1939

Section 161. Imposition of Tax.

(a) Application of tax.—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Computation and payment.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * *

Section 162. Net income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the

amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

* * * *

In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 240

ANDRE MAXIMOV, AS TRUSTEE FOR THE BENEFIT OF H. ROBBIN FEDDEN, U/A DATED 10/24/47, PETITIONER

v.

THE UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

MEMORANDUM FOR THE UNITED STATES

The petitioner is the trustee of an *inter vivos* trust created under the laws of Connecticut. The income beneficiaries (the settlor for life, then his wife for life) and the contingent remaindermen (the settlor's surviving issue) are all residents of the United Kingdom. During 1954 and 1955, the trust realized capital gains which, under Connecticut law, were added to corpus. The question is whether the residence of the beneficiaries caused the trust to be exempt from the United States income tax on those gains under Article XIV of the Income Tax Convention between the United States and the United Kingdom, 60 Stat. (Part 2) 1377, 1384, which provides:

> A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

The Court of Appeals for the Second Circuit held that the trust, being a separate taxable entity not itself qualifying as a "resident of the United Kingdom," was not exempt. That decision is in our view correct, but we acknowledge that it is in conflict with the decision of the Ninth Circuit in *American Trust Co. v. Smyth*, 247 F. 2d 149. The question is of considerable importance; is pending in a number of cases; and can arise also under similar provisions of other conventions. In view of the conflict of decisions, the government does not oppose the granting of the petition for certiorari.

Respectfully submitted.

ARCHIBALD COX,
Solicitor General.

AUGUST 1962.

IN THE

Supreme Court of the United States

October Term, 1962.

No. 240.

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

APPENDIX TO BRIEF FOR PETITIONER.

D. NELSON ADAMS,
DAVID A. LINDSAY,
JOHN A. REED,
JOHN A. CORRY,
Attorneys for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

Of Counsel:

DAVIS POLK WARDWELL SUNDERLAND & KIENDL,
HILL BETTS YAMAOKA FREEHILL & LONGCOPE.

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APPENDIX.

1. INCOME TAX CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE UNITED KINGDOM, 60 STAT. (PART 2) 1377, AS AMENDED, IN EFFECT DURING 1954 AND 1955.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

WHEREAS a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed by their respective Plenipotentiaries at Washington on April 16, 1945;

AND WHEREAS a supplementary protocol modifying in certain respects the said convention was signed by the respective Plenipotentiaries of the United States of America and the United Kingdom of Great Britain and Northern Ireland at Washington on June 6, 1946;

AND WHEREAS the originals of the said convention and the said supplementary protocol are word for word as follows:

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland,

Desiring to conclude a Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have appointed for that purpose as their Plenipotentiaries:

The Government of the United States of America:

Mr. Edward R. Stettinius, Jr., Secretary of State,

and

The Government of the United Kingdom of Great Britain and Northern Ireland:

Appendix.

The Right Honorable the Earl of Halifax, K. G., Ambassador Extraordinary and Plenipotentiary in Washington,

Who, having exhibited their respective full powers, found in good and due form, have agreed as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

(a) In the United States of America: The Federal income taxes, including surtaxes and excess profits taxes (hereinafter referred to as United States tax).

(b) In the United Kingdom of Great Britain and Northern Ireland: The income tax (including surtax), the excess profits tax and the national defense contribution (hereinafter referred to as United Kingdom tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequently to the date of signature of the present Convention or by the government of any territory to which the present Convention is extended under Article XXII.

ARTICLE II

(1) In the present Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America, and when used in a geographical sense means the States, the Territories of Alaska and of Hawaii, and the District of Columbia.

(b) The term "United Kingdom" means Great Britain and Northern Ireland, excluding the Channel Islands and the Isle of Man.

Appendix.

(c) The terms "territory of one of the Contracting Parties" and "territory of the other Contracting Party" mean the United States or the United Kingdom as the context requires.

(d) The term "United States corporation" means a corporation, association or other like entity created or organized in or under the laws of the United States.

(e) The term "United Kingdom corporation" means any kind of juridical person created under the laws of the United Kingdom.

(f) The terms "corporation of one Contracting Party" and "corporation of the other Contracting Party" mean a United States corporation or a United Kingdom corporation as the context requires.

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

(2) For the purposes of Articles VI, VII, VIII, IX and XIV a resident of the United Kingdom shall not be deemed to be engaged in trade or business in the United States in any taxable year unless such resident has a permanent establishment situated therein in such taxable year. The same principle shall be applied, *mutatis mutandis*, by the United Kingdom in the case of a resident of the United States.

(3) In the application of the provisions of the present Convention by one of the Contracting Parties any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the present Convention.

ARTICLE III

(1) A United Kingdom enterprise shall not be subject to United States tax in respect of its industrial or commercial profits unless it is engaged in trade or business in the United States through a permanent establishment situated therein. If it is so engaged, United States tax may be imposed upon the entire income of such enterprise from sources within the United States.

(2) A United States enterprise shall not be subject to United Kingdom tax in respect of its industrial or commercial profits unless it is engaged in trade or business in the United Kingdom through a permanent establishment situated therein. If it is so engaged, United Kingdom tax may be imposed upon the entire income of such enterprise from sources within the United Kingdom: Provided that nothing in this paragraph shall affect any provisions of the law of the United Kingdom regarding the imposition

of United Kingdom excess profits tax and national defence contribution in the case of inter-connected companies.

(3) Where an enterprise of one of the Contracting Parties is engaged in trade or business in the territory of the other Contracting Party through a permanent establishment situated therein, there shall be attributed to such permanent establishment the industrial or commercial profits which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing at arm's length with the enterprise of which it is a permanent establishment, and the profits so attributed shall, subject to the law of such other Contracting Party, be deemed to be income from sources within the territory of such other Contracting Party.

(4) In determining the industrial or commercial profits from sources within the territory of one of the Contracting Parties of an enterprise of the other Contracting Party, no profits shall be deemed to arise from the mere purchase of goods or merchandise within the territory of the former Contracting Party by such enterprise.

ARTICLE IV

Where an enterprise of one of the Contracting Parties, by reason of its participation in the management, control or capital of an enterprise of the other Contracting Party, makes with or imposes on the latter, in their commercial or financial relations, conditions different from those which would be made with an independent enterprise, any profits which would but for those conditions have accrued to one of the enterprises but by reason of those conditions have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Appendix.

ARTICLE V

(1) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which an individual (other than a citizen of the United States) resident in the United Kingdom or a United Kingdom corporation derives from operating ships documented or aircraft registered under the Laws of the United Kingdom, shall be exempt from United States tax.

(2) Notwithstanding the provisions of Articles III and IV of the present Convention, profits which a citizen of the United States not resident in the United Kingdom or a United States corporation derives from operating ships documented or aircraft registered under the laws of the United States, shall be exempt from United Kingdom tax.

(3) This Article shall be deemed to have superseded, on and after the first day of January, 1945, as to United States tax, and on and after the 6th day of April, 1945, as to United Kingdom tax, the arrangements relating to reciprocal exemption of shipping profits from income tax effected between the Government of the United States and the Government of the United Kingdom by exchange of Notes dated August 11, 1924, November 18, 1924, November 26, 1924, January 15, 1925, February 13, 1925 and March 16, 1925, which shall accordingly cease to have effect.

ARTICLE VI

(1) The rate of United States tax on dividends derived from a United States corporation by a resident of the United Kingdom who is subject to United Kingdom tax on such dividends and not engaged in trade or business in the United States shall not exceed 15 percent: Provided that such rate of tax shall not exceed five percent if such resident is a corporation controlling, directly or indirectly, at

least 95 percent of the entire voting power in the corporation paying the dividend, and not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends, other than interest and dividends received from its own subsidiary corporations. Such reduction of the rate to five percent shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing such reduced rate.

(2) Dividends derived from sources within the United Kingdom by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such dividends, and (c) not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom surtax.

(3) Either of the Contracting Parties may terminate this Article by giving written notice of termination to the other Contracting Party, through diplomatic channels, on or before the thirtieth day of June in any year after the year 1945, and in such event paragraph (1) hereof shall cease to be effective as to United States tax on and after the first day of January, and paragraph (2) hereof shall cease to be effective as to the United Kingdom tax on and after the 6th day of April, in the year next following that in which such notice is given.

ARTICLE VII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such interest and not engaged in trade or business in the United States, shall be exempt from United States tax; but such exemption shall not apply to such interest paid by a United States

corporation to a corporation resident in the United Kingdom controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United Kingdom by a resident of the United States who is subject to United States tax on such interest and not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom tax; but such exemption shall not apply to such interest paid by a corporation resident in the United Kingdom to a United States corporation controlling, directly or indirectly, more than 50 percent of the entire voting power in the paying corporation.

ARTICLE VIII

(1) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trademarks, and other like property, and derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such royalties or other amounts and not engaged in trade or business in the United States, shall be exempt from United States tax.

(2) Royalties and other amounts paid as consideration for the use of, or for the privilege of using, copyrights, patents, designs, secret processes and formulae, trademarks, and other like property, and derived from sources within the United Kingdom by a resident of the United States who is subject to United States tax on such royalties or other amounts and not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom tax.

(3) For the purposes of this Article the term "royalties" shall be deemed to include rentals in respect of motion picture films.

ARTICLE IX

(1) The rate of United States tax on royalties in respect of the operation of mines or quarries or of other extraction of natural resources, and on rentals from real property or from an interest in such property, derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax with respect to such royalties or rentals and not engaged in trade or business in the United States, shall not exceed 15 percent: Provided that any such resident may elect for any taxable year to be subject to United States tax as if such resident were engaged in trade or business in the United States.

(2) Royalties in respect of the operation of mines or quarries or of other extraction of natural resources, and rentals from real property or from an interest in such property, derived from sources within the United Kingdom by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such royalties and rentals, and (c) not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom surtax.

ARTICLE X

(1) Any salary, wage, similar remuneration, or pension, paid by the Government of the United States to an individual (other than a British subject who is not also a citizen of the United States) in respect of services rendered to the United States in the discharge of governmental functions, shall be exempt from United Kingdom tax.

(2) Any salary, wage, similar remuneration, or pension, paid by the Government of the United Kingdom to an individual (other than a citizen of the United States who is not also a British subject) in respect of services rendered to the United Kingdom in the discharge of governmental functions, shall be exempt from United States tax.

(3) The provisions of this Article shall not apply to payments in respect of services rendered in connection with any trade or business carried on by either of the Contracting Parties for purposes of profit.

ARTICLE XI

(1) An individual who is a resident of the United Kingdom shall be exempt from United States tax upon compensation for personal (including professional) services performed during the taxable year within the United States if (a) he is present within the United States for a period or periods not exceeding in the aggregate 183 days during such taxable year, and (b) such services are performed for or on behalf of a person resident in the United Kingdom.

(2) An individual who is a resident of the United States shall be exempt from United Kingdom tax upon profits, emoluments or other remuneration in respect of personal (including professional) services performed within the United Kingdom in any year of assessment if (a) he is present within the United Kingdom for a period or periods not exceeding in the aggregate 183 days during that year, and (b) such services are performed for or on behalf of a person resident in the United States.

(3) The provisions of this Article shall not apply to the compensation, profits, emoluments or other remuneration of public entertainers such as stage, motion picture or radio artists, musicians and athletes (Made ineffective by protocol signed June 6, 1946, *infra*).

ARTICLE XII

(1) Any pension (other than a pension to which Article X applies), and any life annuity, derived from sources within the United States by an individual who is a resident of the United Kingdom shall be exempt from United States tax.

(2) Any pension (other than a pension to which Article X applies), and any life annuity, derived from sources within the United Kingdom by an individual who is a resident of the United States shall be exempt from United Kingdom tax.

(3) The term "life annuity" means a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in consideration of money paid.

ARTICLE XIII

(1) Subject to section 131 of the United States Internal Revenue Code as in effect on the first day of January, 1945, United Kingdom tax shall be allowed as a credit against United States tax. For this purpose, the recipient of a dividend paid by a corporation which is a resident of the United Kingdom shall be deemed to have paid the United Kingdom income tax appropriate to such dividend if such recipient elects to include in his gross income for the purposes of United States tax the amount of such United Kingdom income tax.

(2) Subject to such provisions (which shall not affect the general principle hereof) as may be enacted in the United Kingdom, United States tax payable in respect of income from sources within the United States shall be allowed as a credit against any United Kingdom tax payable in respect of that income. Where such income is an

ordinary dividend paid by a United States corporation, such credit shall take into account (in addition to any United States income tax deducted from or imposed on such dividend) the United States income tax imposed on such corporation in respect of its profits, and where it is a dividend paid on participating preference shares and representing both a dividend at the fixed rate to which the shares are entitled and an additional participation in profits, such tax on profits shall likewise be taken into account in so far as the dividend exceeds such fixed rate.

(3) For the purposes of this Article, compensation profits, emoluments and other remuneration for personal (including professional) services shall be deemed to be income from sources within the territory of the Contracting Party where such services are performed.

ARTICLE XIV

A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

ARTICLE XV

Dividends and interest paid on or after the first day of January 1945 by a United Kingdom corporation shall be exempt from United States tax except where the recipient is a citizen of or a resident of the United States or a United States corporation.

ARTICLE XVI

A United Kingdom corporation shall be exempt from United States tax on its accumulated or undistributed earnings, profits, income or surplus, if individuals who are residents of the United Kingdom control, directly or indirectly,

throughout the last half of the taxable year, more than 50 percent of the entire voting power in such corporation.

ARTICLE XVII

(1) The United States income tax liability for any taxable year beginning prior to January 1, 1936 of any individual (other than a citizen of the United States) resident in the United Kingdom, or of any United Kingdom corporation, remaining unpaid on the date of signature of the present Convention, may be adjusted on a basis satisfactory to the United States Commissioner of Internal Revenue: Provided that the amount to be paid in settlement of such liability shall not exceed the amount of the liability which would have been determined if

(a) the United States Revenue Act of 1936 (except in the case of a United Kingdom corporation in which more than 50 percent of the entire voting power was controlled, directly or indirectly, throughout the latter half of the taxable year, by citizens or residents of the United States), and

(b) Articles XV and XVI of the present Convention, had been in effect for such year. If the taxpayer was not, within the meaning of such Revenue Act, engaged in trade or business in the United States and had no office or place of business therein during the taxable year, the amount of interest and penalties shall not exceed 50 percent of the amount of the tax with respect to which such interest and penalties have been computed.

(2) The United States income tax unpaid on the date of signature of the present Convention for any taxable year beginning after the thirty-first day of December 1935 and prior to the first day of January 1945 in the case of an individual (other than a citizen of the United States) resi-

dent of the United Kingdom, or in the case of any United Kingdom corporation shall be determined as if the provisions of Articles XV and XVI of the present Convention had been in effect for such taxable year.

(3) The provisions of paragraph (1) of this Article shall not apply—

(a) unless the taxpayer files with the Commissioner of Internal Revenue on or before the thirty-first day of December 1947 a request that such tax liability be so adjusted and furnishes such information as the Commissioner may require; or

(b) in any case in which the Commissioner is satisfied that any deficiency in tax is due to fraud with intent to evade the tax.

ARTICLE XVIII

A professor or teacher from the territory of one of the Contracting Parties who visits the territory of the other Contracting Party for the purpose of teaching, for a period not exceeding two years, at a university, college, school or other educational institution in the territory of such other Contracting Party shall be exempted by such other Contracting Party from tax on his remuneration for such teaching for such period.

ARTICLE XIX

A student or business apprentice from the territory of one of the Contracting Parties who is receiving full-time education or training in the territory of the other Contracting Party shall be exempted by such other Contracting Party from tax on payments made to him by persons within the territory of the former Contracting Party for the purposes of his maintenance, education or training.

ARTICLE XX

(1) The taxation authorities of the Contracting Parties shall exchange such information (being information available under the respective taxation laws of the Contracting Parties) as is necessary for carrying out the provisions of the present Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of the present Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any person other than those concerned with the assessment and collection of the taxes which are the subject of the present Convention. No information shall be exchanged which would disclose any trade secret or trade process.

(2) As used in this Article, the term "taxation authorities" means, in the case of the United States, the Commissioner of Internal Revenue or his authorized representative; in the case of the United Kingdom, the Commissioners of Inland Revenue or their authorized representative; and, in the case of any territory to which the present Convention is extended under Article XXII, the competent authority for the administration in such territory of the taxes to which the present Convention applies.

ARTICLE XXI

(1) The nationals of one of the Contracting Parties shall not, while resident in the territory of the other Contracting Party, be subjected therein to other or more burdensome taxes than are the nationals of such other Contracting Party resident in its territory.

(2) The term "nationals" as used in this Article means

(a) in relation to the United Kingdom, all British subjects and British protected persons, from the United

Kingdom or any territory with respect to which the present Convention is applicable by reason of extension made by the United Kingdom under Article XXII; and

(b) in relation to the United States, United States citizens, and all persons under the protection of the United States, from the United States or any territory to which the present Convention is applicable by reason of extension made by the United States under Article XXII;

and includes all legal persons, partnerships and associations deriving their status as such from, or created or organized under, the laws in force in any territory of the Contracting Parties to which the present Convention applies.

(3) In this Article the word "taxes" means taxes of every kind or description, whether ational, Federal, state, provincial or municipal.

ARTICLE XXII

(1) Either of the Contracting Parties may, at any time while the present Convention continues in force, by a written notification given to the other Contracting Party through the diplomatic channel, declare its desire that the operation of the present Convention, either in whole or in part or with such modifications as may be found necessary for special application in a particular case, shall extend to all or any of its territories for whose international relations it is responsible, which impose taxes substantially similiar in character to those which are the subject of the present Convention. When the other Contracting Party has, by a written communication through the diplomatic channel, signified to the first Contracting Party that such notification is accepted in respect of such territory or territories,

the present Convention, in whole or in part or with such modifications as may be found necessary for special application in a particular case, as specified in the notification, shall apply to the territory or territories named in the notification on and after the date or dates specified therein. None of the provisions of the present Convention shall apply to any such territory in the absence of such acceptance in respect of that territory.

[Article I of the supplementary protocol signed on May 25, 1954, effective January 19, 1955 [1955] 1 U. S. T. & O. I. A. 37, superseded and replaced Article XXII(1) of the Convention proclaimed on July 30, 1946, which read as follows:

"Article XXII.—(1) Either of the Contracting Parties may, at the time of exchange of instruments of ratification or thereafter while the present Convention continues in force, by a written notification of extension given to the other Contracting Party through diplomatic channels, declare its desire that the operation of the present Convention shall extend to all or any of its colonies, overseas territories, protectorates, or territories in respect of which it exercises a mandate, which impose taxes substantially similar in character to those which are the subject of the present Convention. The present Convention shall apply to the territory or territories named in such notification on the date or dates specified in the notification (not being less than sixty days from the date of the notification) or, if no date is specified in respect of any such territory, on the sixtieth day after the date of such notification, unless, prior to the date on which the Convention would otherwise become applicable to a particular territory, the Contracting Party to whom notification is given shall have informed the other Contracting Party in writing through diplomatic channels that it does not accept

such notification as to that territory. In the absence of such extension, the present Convention shall not apply to any such territory."]

(2) At any time after the expiration of one year from the entry into force of an extension under paragraph (1) of this Article, either of the Contracting Parties may, by written notice of termination given to the other Contracting Party through diplomatic channels, terminate the application of the present Convention to any territory to which it has been extended under paragraph (1), and in such event the present Convention shall cease to apply, six months after the date of such notice, to the territory or territories named therein, but without affecting its continued application to the United States, the United Kingdom or to any other territory to which it has been extended under paragraph (1) hereof.

(3) In the application of the present Convention in relation to any territory to which it is extended by notification by the United States or the United Kingdom references to the "United States" or, as the case may be, the "United Kingdom" shall be construed as references to that territory.

(4) The termination in respect of the United States or the United Kingdom of the present Convention under Article XXIV or of Article VI shall, unless otherwise expressly agreed by both Contracting Parties, terminate the application of the present Convention or, as the case may be, that Article to any territory to which the Convention has been extended by the United States or the United Kingdom.

(5) The provisions of the preceding paragraphs of this Article shall apply to the Channel Islands and the Isle of Man as if they were colonies of the United Kingdom.

Appendix.

ARTICLE XXIII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon exchange of ratifications, the present Convention shall have effect

(a) as respects United States tax, for the taxable years beginning on or after the first day of January 1945;

(b) (i) as respects United Kingdom income tax, for the year of assessment beginning on the 6th day of April 1945 and subsequent years; (ii) as respects United Kingdom surtax, for the year of assessment beginning on the 6th day of April 1944 and subsequent years; and (iii) as respects United Kingdom excess profits tax and national defence contribution, for any chargeable accounting period beginning on or after the first day of April 1945 and for the unexpired portion of any chargeable accounting period current at that date.

ARTICLE XXIV

(1) The present Convention shall continue in effect indefinitely but either of the Contracting Parties may, on or before the 30th day of June in any year after the year 1946, give to the other Contracting Party, through diplomatic channels, notice of termination and, in such event, the present Convention shall cease to be effective.

(a) as respects United States tax, for the taxable years beginning on or after the first day of January in the year next following that in which such notice is given;

(b) (i) as respects United Kingdom income tax, for any year of assessment beginning on or after the 6th day of April in the year next following that in which such notice is given; (ii) as respects United Kingdom surtax, for any year of assessment beginning on or after the 6th day of April in the year in which such notice is given; and (iii) as respects United Kingdom excess profits tax and national defence contribution, for any chargeable accounting period beginning on or after the first day of April in the year next following that in which such notice is given and for the unexpired portion of any chargeable accounting period current at that date.

(2) The termination of the present Convention or of any Article thereof shall not have the effect of reviving any treaty or arrangement abrogated by the present Convention or by treaties previously concluded between the Contracting Parties.

IN WITNESS WHEREOF the above-mentioned Plenipotentiaries have signed the present Convention and have affixed thereto their seals.

DONE at Washington, in duplicate, on the 16th day of April, 1945.

For the Government of the United States of America:

E. R. STETTINIUS, JR.

For the Government of the United Kingdom of Great Britain and Northern Ireland:

HALIFAX.

Appendix.

PROTOCOL (60 Stat. (Part 2) 1389)

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland,

Desiring to conclude a supplementary Protocol modifying in certain respects the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income which was signed at Washington on April 16, 1945,

Have agreed as follows:

ARTICLE I

Paragraph (3) of Article XI of the Convention of April 16, 1945, for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income shall be deemed to be deleted and of no effect.

ARTICLE II

This Protocol, which shall be regarded as an integral part of the said Convention, shall be ratified and the instruments of ratification thereof shall be exchanged at Washington.

In Witness Whereof the undersigned Plenipotentiaries, being authorized thereto by their respective Governments, have signed this Protocol and have affixed thereto their seals.

Done at Washington, in duplicate, this sixth day of June 1946.

For the Government of the United States of America:

James F. Byrnes,
Secretary of State of the United States of America.

For the Government of the United Kingdom of Great Britain and Northern Ireland:

John Balfour,
His Majesty's Envoy Extraordinary and Minister Plenipotentiary in Washington.

2. MATERIAL PARTS OF THE INTERNAL REVENUE CODE OF 1954 RELATING TO THE TAXATION OF TRUST INCOME.

Sec. 641. Imposition of Tax.

(a) *Application of tax.*—The taxes imposed by this chapter on individuals shall apply to the taxable income of estates or of any kind of property held in trust, including—

(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and Payment.*—The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary.

(26 U. S. C. 1958 ed., Sec. 641)

SEC. 642. SPECIAL RULES FOR CREDITS AND DEDUCTIONS.

* * * * * *

(c) *Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.*—In the case of an estate or trust (other than a trust meeting the specifications of subpart B) there shall be allowed as a deduction in computing its taxable income (in lieu of the deductions allowed by section 170(a), relating to deduction for charitable, etc., contributions and gifts) any amount of the gross income, without limitation, which pursuant to the terms of the governing instrument is, during the taxable year, paid or permanently set aside for a purpose specified in section 170(c), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, or for the establishment, acquisition, maintenance or operation of a public cemetery not operated for profit. For this purpose, to the extent that such amount consists of gain from the sale or exchange of capital assets held for more than 6 months, proper adjustment of the deduction otherwise allowable under this subsection shall be made for any deduction allowable to the estate or trust under section 1202 (relating to deduction for excess of capital gains over capital losses). In the case of a trust, the deduction allowed by this sub-

section shall be subject to section 681 (relating to unrelated business income and prohibited transactions)."

(26 U. S. C. 1958 ed., Sec. 642)

SEC. 643. DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D.

(a) *Distributable Net Income.*—For purposes of this part, the term "distributable net income" means, with respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

* * * * * *

(3) *Capital Gains and Losses.*—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year * * *.

* * * * * *

(26 U. S. C. 1958 ed., Sec. 643)

SEC. 651. DEDUCTION FOR TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

(a) *Deduction.*—In the case of any trust the terms of which—

(1) provide that all of its income is required to be distributed currently, and

(2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 642 (c) (relating to deduction for charitable, etc., purposes),

there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently. This section shall not apply in any taxable year

in which the trust distributes amounts other than amounts of income described in paragraph (1).

* * * * * *

(26 U. S. C. 1958 ed., Sec. 651)

Sec. 652. Inclusion of Amounts in Gross Income of Beneficiaries of Trusts Distributing Current Income Only.

(a) *Inclusion.*—Subject to subsection (b) the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. * * *

* * * * * *

(26 U. S. C. 1958 ed., Sec. 652)

Sec. 661. Deduction for Estates and Trusts Accumulating Income or Distributing Corpus.

(a) *Deduction.*—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

* * * * * *

(26 U. S. C. 1958 ed., Sec. 661)

SEC. 662. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) *Inclusion.*—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) *Amounts Required to be Distributed Currently.*—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. * * *

(2) *Other Amounts Distributed.*—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year.* * *

* * * * * *

(26 U. S. C. 1958 ed., Sec. 662)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 240.

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR PETITIONER.

D. NELSON ADAMS,
DAVID A. LINDSAY,
JOHN A. REED,
JOHN A. CORRY,
Attorneys for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

Of Counsel:
DAVIS POLK WARDWELL SUNDERLAND & KIENDL,
HILL BETTS YAMAOKA FREEHILL & LONGCOPE.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 240.

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR PETITIONERS.

Opinions Below.

The opinion of the United States District Court for the Southern District of New York (R. 17-18) is not officially reported. The opinion of the United States Court of Appeals for the Second Circuit (R. 20-30) is reported at 299 F. 2d 565.

Jurisdiction of this Court.

The jurisdiction of this Court is invoked under 28 U. S. C. 1254(1).

The judgment of the United States Court of Appeals was entered on February 14, 1962 (R. 30).

The petition for a writ of certiorari was timely filed on July 10, 1962 and was granted on October 8, 1962 (R. 32).

Treaties, Statutes and Regulations Involved.

Article XIV of the Income Tax Convention with the United Kingdom (hereinafter sometimes referred to as the "Treaty") provides:

> "A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets."

The text of the Treaty and material parts of the Internal Revenue Code of 1954 relating to the taxation of trust income are printed in our Appendix separately bound.

Section 894 of the Internal Revenue Code of 1954 (26 U. S. C. 1958 ed. §894) provides:

> "Sec. 894. Income Exempt under Treaty
>
> Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle."

Section 22(b)(7) of the Internal Revenue Code of 1939, 53 Stat. 10, was to substantially the same effect, and was first enacted as Section 22(b)(7) of the Revenue Act of 1936, 49 Stat. 1658.

Section 7852(d) of the Internal Revenue Code of 1954 (26 U. S. C. 1958 ed. §7852(d)) provides:

> "(d) Treaty Obligations.—No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title."

A similar provision first appeared as Section 109 of the Revenue Act of 1942, 56 Stat. 808, and was found in each

successive Revenue Act until Section 7852(d) was incorporated as part of the Internal Revenue Code of 1954.

Treasury Decision 5569 comprises the Commissioner's regulations applicable to the Treaty. 1947-2 Cum. Bull. 100. Section 7.519, subparagraph (c), of T. D. 5569 provides:

> "(c) *Beneficiaries of an Estate or Trust.*—A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, provided in Articles VI, VII, VIII, IX and XIV of the convention with respect to dividends, interest, royalties, natural resource royalties, rentals from real property and capital gains to the extent such item or items are included in his distributive share of income of such estate or trust if he is taxable in the United Kingdom on such income and is not engaged in trade or business in the United States through a permanent establishment."

Section 7.514 of T. D. 5569 sets forth the specific classes of income from sources within the United States which are considered exempt under the Treaty. Among these are:

> "(g) Gains from the sale or exchange of capital assets by a non-resident alien who is a resident of the United Kingdom or by a foreign corporation managed and controlled in the United Kingdom, if such alien or corporation has no permanent establishment in the United States (Article XIV);"

Question Presented.

Does the exemption accorded by Article XIV of the United Kingdom Treaty embrace capital gains on property held in a domestic trust, where such gains are retained as corpus for future distribution and when all the benefi-

ciaries of the trust, the income beneficiaries and remaindermen alike, are residents of the United Kingdom not engaged in trade or business in the United States?

Statement of the Case.

1. The Facts.

The petitioner is the duly qualified successor trustee of an *inter vivos* trust created on October 24, 1947 by H. Robbin Fedden (hereinafter sometimes referred to as the grantor) (R. 9-15, 16). Under the trust instrument the income is payable to the grantor during his lifetime. On his death the income is to be paid during her life to his wife, should she survive him and be married to him upon his death. Upon the deaths of the grantor and his wife the principal is to be paid over to the grantor's then surviving issue in equal shares per stirpes, or if any such issue shall be under twenty-one years of age, shall be retained in trust for his benefit until he reaches twenty-one years. If no issue survive the grantor and his wife, the principal shall be paid over to such persons as the grantor shall appoint by will or if he shall fail to do so, under the laws of intestate succession of the State of Connecticut (R. 10-11).[1]

During 1954 and 1955 the grantor, H. R. Fedden, his wife, Renee Fedden, and his children (Katherine, age 16, and Frances, age 12, as of November, 1960) who constituted their only issue, were citizens and residents of the United

[1] In addition, under the trust instrument, the trustee is granted the power under certain circumstances to pay over any of the principal to the then income beneficiary. The grantor has certain powers over investments and also reserves the right to terminate the trust at any time after twenty years from the date of its creation on six months notice (R. 11, 12, 15). While these additional facts might have formed the basis for an argument that the grantor rather than the trustee was the taxpayer in respect of the capital gains involved in this case under the provisions of Sections 671-677 of the Internal Revenue Code of 1954, this argument was not made in the proceedings below or in the petition for certiorari, and is not raised by petitioner before this Court.

Kingdom and were not engaged in trade or business in the United States (R. 16-17). Since October, 1947, the grantor has been employed in the United Kingdom by the National Trust for Places of Historic Interest or Natural Beauty, and since January, 1951, has held the position of Historic Buildings Secretary. He has been in the United States only once, in October of 1958, for a period of about three weeks on a speaking tour on behalf of the National Trust (R. 17).

During its taxable years 1954 and 1955 the trust realized capital gains from the sale of securities (R. 2-3). These gains were allocated to the principal of the trust under Connecticut law, which by the terms of the trust instrument governs the rights of the parties interested in the trust estate (R. 7, 14). The trustee duly filed Federal income tax returns reporting such gains, and paid the District Director of Internal Revenue capital gains taxes thereon of $53.10 for 1954 and $1,316.32 for 1955 (R. 2). Thereafter, claims for refund were filed with the District Director of Internal Revenue, asserting that such taxes were erroneously collected (R. 4-8). These claims for refund were denied in full (R. 3).

2. The Proceedings Below.

Petitioner brought an action for the recovery of such taxes in the United States District Court for the Southern District of New York, the jurisdiction of which was invoked under 28 U. S. C. 1346(a)(1) (R. 2-3). The Court, in a memorandum opinion dated January 4, 1961 by Judge MacMahon, on cross-motions for summary judgment, held for the plaintiff. Judge MacMahon based his decision upon the decision of the United States Court of Appeals for the Ninth Circuit in *American Trust Company v. Smyth*, 247 F. 2d 149 (1957), observing that in the *American Trust*

Company case, the Court held that the intent of the Convention was to effect full reciprocity and equality of tax treatment between nationals of the two countries and that the individual beneficiaries who would feel the economic burden of the tax were entitled to the exemption provided by the treaty (R. 17-18). Judgment for the plaintiff was entered on January 4, 1961 (R. 18).

On February 28, 1961 the respondent appealed from this judgment to the United States Court of Appeals for the Second Circuit (R. 20). On February 14, 1962 that Court, in an opinion by Judge Clark, reversed the District Court and held that while currently distributable capital gains realized by a United States trust are exempt from Federal income tax under the Convention, capital gains which are held for future distribution are not exempt. The Court rested its decision on the grounds that "the exemption of Article XIV explicitly applies only to residents of the United Kingdom", the "trust is not a United Kingdom resident and the income here is treated in United States law as that of the trust" (R. 22-3) and the "technical language" of the Treaty, "in conjunction with the Internal Revenue Code, as incorporated by Article II(3), recognizes the trust as a separate taxable entity" (R. 28).

In conjunction with the foregoing analysis, the Court below found that "the broad aim of the Convention, as with income tax treaties generally, was to facilitate commercial enterprise between the two countries", that the "prime target was double taxation" and that a "primary motivation for inclusion of provision equalizing tax treatment such as Article XIV was reduction of tax barriers to the free movement of individuals for commercial purposes" (R. 27-8). The Court concluded:

> "And exemption here is unnecessary to achieve these ends. There can be no double taxation, since

neither the beneficiary nor the ultimate recipients of the corpus will be taxable in the United Kingdom on these gains. Thus we cannot see that such an exemption would affect commercial intercourse between the two countries in any significant manner" (R. 28).

Summary of Argument.

1. The question as to whether the exemption accorded residents of the United Kingdom embraces gains on the sale of securities held in a domestic trust, when the gains are retained for future distribution, depends on the meaning of the word "exempt" as used in context and in light of the purpose of Article XIV. The sole purpose of Article XIV was to match a pre-existing British exemption, and thus provide complete exemption from taxation. In order to carry out the reciprocal purpose of the Article, the term "exempt" must be construed in accordance with its commonly understood meaning, signifying release from the economic burden of tax. Capital gains are not taxed in the United Kingdom on the theory that such gains represent capital or corpus and not income or profits. It is irrational in applying this Treaty exemption to make a distinction between distributed and undistributed capital gains where such gains are accumulated under state law because they are regarded as part of the trust corpus and not income. More restrictive language, suggestive of the narrow construction pressed by the Government in this case was readily available and exists in earlier treaties but was discarded in the United Kingdom Treaty.

2. In the course of the Treaty negotiations, the United Kingdom insisted that the tax laws of the respective countries be placed on a reciprocal basis before accepting

provisions for exchange of information and reciprocal enforcement. The Treaty thus secures exemptions for investment income solely in order to achieve reciprocity in areas unrelated to commercial enterprise, double taxation or fiscal evasion. An article-by-article analysis of the Treaty shows the extent to which the negotiators sought to achieve reciprocity and equality in terms of economic burden in tax treatment of the nationals of each country.

3. The economic burden of a tax imposed upon gains in trust necessarily falls upon the trust beneficiaries, and not upon the trustee, who acts in a fiduciary capacity only. In the years the taxes were imposed, the United Kingdom beneficiaries were presumptive takers of the accumulated gains and, as residents of the United Kingdom, qualified for the treaty exemption. The facts as they existed in the years of sale are controlling notwithstanding possible future change in the exempt status of the beneficiaries.

4. The concept of a trust as a "separate taxable entity" is not recognized for all purposes in the Treaty and is not an inviolate principle of domestic taxation. The Treaty definitions, read in conjunction with domestic law, do not defeat the exemption when applied to the gains here involved. Clear, overriding language that would unquestionably tax the gains to the United States trust in this case, found in all tax treaties in effect before the United Kingdom Treaty was signed and in most treaties since, was significantly omitted from the United Kingdom Treaty. Our domestic scheme of taxing trusts insures that taxable income is taxed at least once, either to the beneficiary if the income is distributed or to the trust if the income is accumulated, but a trust does not change the character of the

income and does not create a tax on income that is intended to be exempt.

5. Congress has specifically provided that treaty obligations of the United States, including exemptions from gross income, should have full force and effect notwithstanding any provision of our Internal Revenue Code to the contrary. There is therefore no reason to introduce domestic tax concepts into the construction of Article XIV when, as in this case, to do so would defeat its primary objective. Instead, Article XIV should be liberally construed so as to carry out the apparent intention of the parties to secure equality and reciprocity between them.

6. The Treasury Regulations under the Treaty are patently defective and their application would render Article XIV almost totally inoperative in the case of gains realized by a domestic trust. While these Regulations are similar to the regulations interpreting earlier tax treaties, those conventions contain different language from Article XIV and, unlike the United Kingdom Treaty, expressly provide for the promulgation of interpretative regulations. Therefore, the Regulations should not be given controlling weight.

ARGUMENT.

I.

The Exemption Accorded by Article XIV Embraces Capital Gains on Property Held in a Domestic Trust, Whether Such Gains Are Currently Distributable or Are Retained for Future Distribution.

1. Article XIV Must Be Construed to Relieve the United Kingdom Beneficiaries from the Burden of Capital Gains Tax in Order to Secure the Equality and Reciprocity to Which Article XIV Was Addressed.

The petitioner maintains that not only Article XIV but the Treaty as a whole indicates an objective to accomplish reciprocity in terms of economic burden of tax. It is first necessary, however, to examine the terms of the Convention, and relevant precedents in our domestic law, to determine the meaning of the term "exempt" in the context of Article XIV.

Article XIV provides in broad and simple language:

> "A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets."

The only guidance as to the meaning of the terms used in Article XIV may be found in Article II(3) of the Treaty, which provides:

> "In the application of the provisions of the present Convention by one of the Contracting Parties any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the present Convention."

Article II(3), as a reading of it indicates, is directed at any "term" of the Treaty not otherwise defined. The only "terms" in Article XIV with which we are concerned are "A resident of the United Kingdom", "engaged in trade or business in the United States", "exempt", "sale or exchange" and "capital assets". The term "trust" does not appear in Article XIV or elsewhere in the Treaty.[2]

It is not disputed that all the beneficiaries, the income beneficiaries and remaindermen alike, are "residents of the United Kindom", "not engaged in trade or business in the United States", and that the gains involved are "gains from the sale or exchange of capital assets". The answer to the question whether the exemption accorded residents of the United Kingdom embraces gains on the sale of securities held in a domestic trust, when the gains are retained for future distribution, necessarily depends on the meaning of "exempt" or "exempt from United States tax" as used in context and in light of the purpose of Article XIV.

The term "exempt" is nowhere defined in the Treaty or in our Internal Revenue Code.

An analysis of our revenue laws shows that there was and is no uniform or consistent meaning attaching to the word "exempt". In certain instances it is coupled with the words "credits" or "deductions"[3]; in other instances it is

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[2] By way of contrast, a corporation is defined in Article II(1)(d) and (e) as a distinct "entity" or "juridical person". Nowhere in the Treaty is a trust accorded recognition as an "entity" or "juridical person".

[3] The Internal Revenue Code of 1939, rather than the Internal Revenue Code of 1954, was in effect at the time the United Kingdom Treaty was negotiated and made effective. Some of the terms used in the 1954 Code have been changed without any intended substantive change in meaning, as the context indicates. Section 25 of the 1939 Code authorizes the "following credits against net income" including "an exemption of $600 for the taxpayer" and additional "exemptions of $600 for his spouse and for each dependent" 62 Stat. 112. Section 151 of the 1954 Code, 26 U. S. C. §151, allows such exemptions as "deductions" in computing taxable income.

in addition to the phrase "shall not be included in gross income"[4]; and in some the word "exempt" attaches to a defined institution,[5] or attaches to the item, regardless of the recipient of the item.[6] Thus, the precise meaning in which the word is used depends entirely upon the context.

In the absence of a fixed statutory definition of a word, it is appropriate to conclude that the word is to be given its normal meaning. The generally accepted meaning of "exempt", as defined in our standard dictionaries of the English language, is "to free, except, or excuse from some burdensome condition or obligation, or the operation of some law to which others are subject." Funk & Wagnalls, *New Standard Dictionary of the English Language,* 872 (1947 ed.). The 1950 edition of the same publication, carried a secondary meaning, "free or excused from some burden or obligation; as exempt from taxation" *id.* at 348.

Our courts have frequently adopted and applied this meaning. *Maine Water Co.* v. *City of Waterville,* 93 Me. 586, 45 Atl. 830, 833 (1900); *In re Matter of Sowers,* 60 N. C. 459, 461 (1864); *Koenig* v. *Omaha & N. W. R. Co.,* 3 Neb. 373, 380 (1874); *Florer* v. *Sheridan,* 137 Ind. 28, 36 N. E.

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[4] Section 22(b) of the 1939 Code reads "the following items shall not be included in gross income and shall be exempt from taxation" 53 Stat. 10. See also Section 894 of the Internal Revenue Code of 1954, 26 U. S. C. §894.

[5] Thus Section 501(a) of the 1954 Code provides that certain described organizations "shall be exempt from taxation under this subtitle" 26 U. S. C. §501(a).

[6] A well known example is interest on obligations of a state, territory or any political subdivision thereof. Section 22(b)(4) of the 1939 Code provides that such items "shall not be included in gross income and shall be exempt from taxation under this chapter", 53 Stat. 10, whereas Section 103(a) of the 1954 Code simply provides that "gross income does not include interest on—(1) the obligations of a state, territory or possession of the United States", etc., 26 U. S. C. §103(a).

365, 369 (1894). Thus in *Maine Water Co.* v. *City of Waterville, supra,* the Supreme Court of Maine said:

> "The term 'exemption' implies a release from some burden, duty, or obligation. 'It is a grace, a favor, an immunity; taken out from under the general rule, not to be like others who are not exempt; . . . .'"

In the context of Article XIV, the term "exempt" should be taken at its ordinary meaning, and not in any artificial or narrow technical sense, unless such restricted sense is clearly intended. See *Geofroy* v. *Riggs,* 133 U. S. 258, 271 (1890). The Ninth Circuit in *American Trust Company* v. *Smyth* accordingly held that the term "exempt" as used in Article XIV "was employed in its broadest meaning, signifying a release from economic burden" (247 F. 2d at 153), and embraced capital gains held in a domestic trust and retained for future distribution. In the words of the Ninth Circuit (p. 152):

> "We conceive the purpose of the Treaty to have been full reciprocity and equality of tax treatment between nationals of the United States and the United Kingdom. Such being the case, this purpose requires a broad construction of Article XIV, so as to relieve the British beneficiaries from the burden of the capital gains tax to the same extent, in a given situation, as a United States beneficiary would be in a similar position in the United Kingdom."

The sole object of Article XIV was to equalize tax treatment between the nationals of the two countries with respect to capital gains. The United States has treated such gains or profits as taxable income, taxing the gains as ordinary income if the property sold is held for less than a stated period (now six months), and if held for a

longer period at not in excess of a flat rate (now 25%). The United Kingdom has not taxed such gains,[7] except in the case of so-called "trading profits" not applicable in the case of the sales here involved. This difference in rule applies generally, whether the property sold is owned outright or is held in trust. Thus in the case of a United Kingdom trust with the life beneficiaries and remaindermen all residents of the United States, a gain realized on a sale by the trustee of the trust corpus is not subject to tax in the United Kingdom. Here we have involved a reverse but like situation.

The parties who negotiated the Treaty clearly conceived of Article XIV as a provision designed to grant reciprocity to residents of the United Kingdom. The Technical Memorandum of the Treasury Department on the Treaty, Exec. Rept. No. 4, 79th Cong., 2d Sess. 12 (1946) (hereinafter cited as Senate Report), after discussing the fact that capital gains are not included in the United Kingdom tax base unless regarded as a trading profit, makes the following observation (p. 19):

> "It is because of this factor [the difference in tax systems] that it was found impracticable to make the Article [XIV] reciprocal on its face even though it is so in fact."

Notwithstanding this historical background of Article XIV, the Court below argued that "the broad aim" of the Convention was to facilitate commercial enterprise,[8] that

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[7] After the adoption of the Treaty, and after the sales here involved, the United Kingdom, under Section 10 of the Finance Act of 1962, 10 & 11 Eliz. 2. Ch. 44, imposed income tax upon the disposition of land within three years after its acquisition and upon the disposition of other property within six months after its acquisition.

[8] The Court below cited as its authority for this statement a memorandum prepared for the Committee on Foreign Relations which is printed in the Hearings on the Income and Estate Tax Conventions with the United Kingdom before a Subcommittee of

its "prime target" was the problem of double taxation. (R. 27-28) and that:

> "* * * exemption here is unnecessary to achieve these ends. There can be no double taxation, since neither the beneficiary nor the ultimate recipients of the corpus will be taxable in the United Kingdom on these gains. Thus we cannot see that such an exemption would affect commercial intercourse between the two countries in any significant manner." (R. 28)

This analysis is based on a fundamental misconception of the objectives which Article XIV and the Treaty as a whole were intended to accomplish. Indeed, if the analysis of the Court below were correct, Article XIV has no place in the Treaty.

As we will show below in Section 2, the Treaty has as much to do with investment income as with commercial profits,[9] and Article XIV, as well as other articles, deals primarily with investment rather than business income.[10] Similarly, if, as the Court below stated, the "prime target" of the Treaty was "double taxation", there would be no reason for the existence of Article XIV since even with its exclusion there could have been no double taxation in view of the absence of any British tax on capital gains.

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the Committee on Foreign Relations of the United States Senate, 79th Cong. 1st Sess. pp. 23, 27 (1945) (hereinafter cited as Hearings); However, the memorandum merely states that this was "one of the basic objectives of the Convention".

[9] *Infra* pp. 19-23.

[10] The position urged by the government in this case might tend to limit use of United States trusts by United Kingdom residents, who would be more likely to establish trusts in jurisdictions other than the United States which impose no tax upon capital gains. Such a result can only be detrimental to the financial community in the United States vis-a-vis competing foreign financial institutions, without compensating increase in tax revenues for the United States and indeed with the likelihood of a net reduction in such revenues.

The sole purpose of Article XIV was to match a pre-existing British exemption, and thus provide complete exemption from taxation. Single, not double taxation was the barrier to be removed.

The Court below also pointed to different concepts of capital gains in the United States and the United Kingdom and accordingly observed that Article XIV "does not achieve complete equality" (R. 25). However, in the instances referred to by the Court below in which the United Kingdom imposes its standard tax on transactions which are considered to be the sale or exchange of capital assets under United States law, both the Treasury Memorandum in the Senate Report (p. 19) and the testimony at the Hearings (p. 75) show that this result was recognized as an exception to the general equality provided by Article XIV and was accepted as such.[11] These exceptions should not be allowed to obscure the fact that the overriding purpose of Article XIV was to achieve equality. Whatever fringe areas of differences in concept may exist, the one clear case in which the concept of capital gain is the same under the tax laws of both parties to the Treaty is the gain from the sale of capital assets held in trust. A trustee or fiduciary is governed by the rule of the "prudent" investor, and

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[11] These transactions, which the United Kingdom regards as involving trading profits, are similar to the trading activities which this Court in *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46 (1955) has held do not constitute the sale or exchange of capital assets, notwithstanding the fact that none of the exceptions to the definition of "capital asset" contained in 1939 Code Section 117(a) 53 Stat. 50 (1954 Code Section 1221) literally applied to the assets involved in that case. Subsequent cases have interpreted the *Corn Products* decision as holding that the concept of capital gains is a restricted one, which should be narrowly interpreted wherever possible. *Greene-Haldeman* v. *Commissioner*, 282 F. 2d 884 (9th Cir. 1960), *Lockhart* v. *Commissioner*, 258 F. 2d 343 (3d Cir. 1958). Thus, many of the apparent diversities in the definition of capital gains between the United States and the United Kingdom are more illusory than real and their scope is substantially less than the Court below has indicated.

typically does not engage in trading profits or short term speculation.

It is not disputed that the exemption in Article XIV applies to capital gains on the sale of property held by a United States trustee in trust for British beneficiaries. It is contended only that the exemption is inapplicable when the gains are held for future distributions. Yet in applying the treaty exemption, it is irrational to make a distinction between distributable and undistributed capital gains. In both instances the gains arise on the sale of property held in trust and the trustee holds the legal title of the property sold. Whether the gain is distributable or not distributable, the trustee acts in a representative capacity only. In both instances the economic burden of the tax falls on the beneficiaries.

No distinction between distributed or retained capital gains is made for United Kingdom tax purposes in the reverse situation, when the trust is located in the United Kingdom, and the beneficiaries are resident in the United States.[12]

Capital gains of the kind here involved have been exempt in the United Kingdom on the theory that such gains

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[12] The Court below cited Harvard Law School, World Tax Series, Taxation in the United Kingdom, ¶¶5/3.1, 5/3.4, pp. 125, 127 (1957) in Footnote 2 (R. 23) to the effect that under British law, the term "person" encompasses a trust.

The cited volume of the World Tax Series points out that a trustee is not assessed with surtax in respect of trust income (¶10/7.1, p. 307) and that for surtax purposes, income which has accumulated in trust is includable in the total income of a beneficiary whose interest in the accumulation is vested. If the beneficiary's interest in accumulated income is contingent, such income is not taxable either to the trust or to the beneficiary (¶10/7.2, p. 308). On the other hand the standard tax is imposed on the trustee whether or not the income is distributed. However, the taxability of trust income from sources outside the United Kingdom in certain instances depends on the residence status of the beneficiary and not on the residence of the trust. ¶¶5/3.4, 10/7.1, pp. 127, 307.

represent capital or corpus and not income or profits.[13] In this country, where profit arises on the sale of property held in trust, in the absence of any direction in the trust instrument the profit is distributable or is retained for future distribution depending on the law of the state under which the trust is created. To the extent the state law disagrees with the British concept and regards such gains as income and not corpus, such gains would be distributable and the exemption under Article XIV would admittedly apply. Under the government's view of this case, however, to the extent state law agrees with the British concept and regards such gains as part of the trust corpus, our government seeks to remove such gain from the treaty exemption in the face of a treaty provision that has no other function than to match the British exemption.

Article XIV was drafted in broad and simple language. More restrictive language was readily available and exists in each of the three earlier tax treaties entered into by the United States. The earlier conventions no doubt served as convenient models, and no reason existed for departing from the language consistently available, except as concessions or "give and take" in the negotiations required. Thus, the conventions with Sweden[14] and Canada[15] each provided:

> "Gains derived in one of the contracting States from the sale or exchange of capital assets by a resident or a corporation or other entity of the other contracting State shall be exempt from taxation in

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[13] Harvard Law School, World Tax Series, Taxation in the United Kingdom, ¶9/8.1, p. 277.

[14] Article IX (54 Stat. 1764), effective January 1, 1940.

[15] Article VIII (56 Stat. 1402), effective January 1, 1942. Article 11 of the French Treaty (59 Stat. 899), effective January 1, 1945, is similar except that the words "stocks, securities or commodities" appear in the place of the words "capital assets".

the former State, provided such residents or corporation or other entity has no permanent establishment in the former State."

As in the case of the United Kingdom, Sweden, Canada and France did not tax capital gains in any event, and therefore there was no more reason to phrase the capital gains provisions in those treaties in reciprocal terms than in the case of the United Kingdom Treaty. Yet, the terms gains "derived" from the "sale" or exchange "by a resident or a corporation or other entity" were discarded in the United Kingdom Treaty for the broad mandate that a "resident of the United Kingdom" not engaged in trade or business in the United States "shall be exempt from United States tax on gains from the sale or exchange of capital assets." Viewed in the context of the reciprocity which Article XIV was intended to accomplish, this change of language cannot be ignored.

2. Throughout the Treaty A Prime Objective Was the Accomplishment of the Fullest Possible Reciprocity of Treatment in Terms of Economic Burden of Tax.

As the Court below recognized (R. 24), in determining the scope of the exemption contained in Article XIV, the several articles of the Treaty as a whole must be considered in order to determine the intent of the negotiators. *In re Ross*, 140 U. S. 453, 475 (1891); *Rocca* v. *Thompson*, 223 U. S. 317, 331-332 (1912). However, the analysis of the "broad aim" of the Treaty by the Court below closely follows the original intent of the United States, but not the intent of the United Kingdom. The United States was primarily interested in establishing mutual credit provisions in order to avoid double taxation. The United Kingdom preferred a source exemption system. The United States preferred system was finally adopted for "business

income" or "commercial profits" and the United Kingdom preferred system was adopted for "investment" income. Thus Eldon P. King, Special Deputy Commissioner, Bureau of Internal Revenue, testified before a Subcommittee of the Senate Foreign Relations Committee as follows (Hearings, *supra*, n. 7, p. 58):

> "Since in dealing with its own citizens, residents, and corporations, the United States has long employed a credit system through which it permits deduction of the foreign tax from the United States tax imposed on the foreign income, it has naturally turned to this solution as a part of a tax-convention plan. It was found, however, that Britain preferred the more direct system of eliminating double taxation through exemption from tax at source so the convention reflects a compromise of the two plans. Thus, in most matters of business income and in certain instances affecting earned income, the credit system is employed as a means of eliminating double taxation, while in most matters of investment income the source exemption system is used."

The United States was also interested in problems of fiscal evasion, but this proved an initial barrier for the conclusion of the Treaty. In the words of Eldon P. King (Hearings, pp. 56-7):

> "In a preliminary exploration with Britain in 1937 looking toward a tax convention, it was recognized that the British policy of fiscal secrecy and British objections to alleged extraterritorial practices on the part of the United States formed the greatest barriers to the conclusion of a tax convention between the two countries."

In the course of the negotiations, it became necessary to place the tax laws on a substantially reciprocal basis before a plan for reciprocal enforcement could be made acceptable

to the United Kingdom. Eldon P. King stressed the importance of this point in his testimony (Hearings, p. 57):

> "In certain instances in the present convention, such as those referred to in some of the committee's objections, the countries have proposed to place their laws on substantially a reciprocal basis before joining in a plan for reciprocal enforcement. It follows that should the United States desire to withdraw from some of such substantive provisions, Britain would be in a position to withdraw, wholly or qualifiedly, from the administrative provisions."

An article-by-article analysis of the Treaty bears out the extent to which the parties extended this concept of reciprocity. The Treaty, the full text of which is printed in the Appendix, contains twenty-four articles. Of these, seventeen undeniably secure thoroughgoing reciprocity, with mutually reciprocal provisions cast in virtually identical language, namely, Articles I-V, VII, VIII, X, XI, XII and XVIII-XXIV.

Articles V, VII, VIII, X, XI and XII contain mutually reciprocal exemption provisions. In view of the reciprocal tax credit provisions of Article XIII, these articles are unnecessary to eliminate the possibility of double taxation. Their significance is that they provide a complete parity of tax treatment for nationals of both parties which would not have existed in their absence. Also, despite the statement of the Court below that the aim of the Treaty was to facilitate commercial exchange between the two countries, Article VII exempts interest from tax only if the recipient is *not* engaged in trade or business in the country from which such interest is derived, and the exemption of royalties contained in Article VIII is similarly conditioned.

In Articles XIV, XV, XVI and XVII the prime target was single taxation. As in the case of capital gains in

Article XIV, in Articles XV[16] and XVI[17] (as well as Article XVII, which makes Articles XV and XVI effective in respect of prior unpaid taxes due by residents and corporations of the United Kingdom) the United States agreed to a tax exemption not otherwise accorded by our tax laws so as to match the United Kingdom rule, which did not impose any tax in corresponding situations. Memorandum Prepared for the Committee on Foreign Relations Hearings, *supra*, n. 7 at p. 25.

The remaining articles, namely Articles VI, IX and XIII especially illustrate the extent to which the negotiators went in assuring reciprocity from the standpoint of economic burden of taxation, disregarding the technical identity of the "taxpayer" under domestic law.

Article VI reduces the United States withholding tax on dividends received from a United States corporation by a United Kingdom resident (normally 30%) to 15%, while dividends received by a resident of the United States from a United Kingdom corporation are made exempt from the British surtax. At the time of the adoption of the Convention the corporate profits of a United Kingdom corporation were subject to British income tax at a standard rate of 50% and a national defense contribution of 5%, or 55%

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[16] Article XV exempts from United States tax dividends and interest paid by a United Kingdom corporation except where the recipient is a United States citizen or resident. Prior to the Treaty, the United States taxed dividends and interest paid to British residents (and other non-resident aliens) by a United Kingdom corporation which was engaged in business in and derived a certain percentage of its gross income from United States sources (20% in the case of interest and 50% in the case of dividends).

[17] By Article XVI a United Kingdom corporation engaged in business in the United States is made exempt from the United States tax on its accumulated and undistributed earnings, subject to the limitation that residents of the United Kingdom throughout the last half of the taxable year control more than 50% of the voting power.

in all. The stockholder obtained a credit for the purpose of the standard or normal tax equivalent to the tax paid by the corporation, but he was required to pay surtax on the entire dividend. At that time, the United States rate on corporate earnings was 40%. Thus by fixing the withholding rate on dividends received from an American corporation by a resident of the United Kingdom at 15% and at the same time exempting our residents from any surtax on dividends from a United Kingdom corporation, the Treaty placed on the residents of each of the contracting parties the same burden of tax on the pool of corporate earnings, at the rate of 55%.[18]

Article IX also adjusts dissimilar rates, taking account of dissimilarities in the tax base, in order to achieve reciprocal equivalence in the tax burden.[19]

Article XIII, the reciprocal credit provision, is the primary means adopted by the negotiators for eliminating double taxation. However, it is equally significant in that it represents major concessions by both countries in the interest of equality of tax treatment for the nationals of each. The

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[18] Bearing in mind that a change in tax rates by either country might upset the reciprocal balance achieved by Article VI, the parties added a clause, subparagraph (3) of Article VI, providing that either of the contracting parties might terminate Article VI by written notice on or before June 30th of any year after 1945.

[19] By Article IX the current United States withholding rate of tax on royalties from mines and other natural resources and on rentals from real property derived from sources within the United States by a United Kingdom resident was reduced from 30% to 15% of the gross amount received. On the other hand, similar royalties and rentals from sources within the United Kingdom derived by a United States resident were made exempt from the United Kingdom surtax, but under United Kingdom law were subject to the standard or normal tax at the prevailing 50% rate on the net amount received, *i.e.*, after credits and deductions. The testimony presented at the hearings makes it clear that a 15% tax on the gross receipts was viewed as approximately equivalent to a 50% tax on the net receipts. Memorandum Prepared for the Committee on Foreign Relations, Hearings p. 24.

United Kingdom made a major legal and policy adjustment by agreeing to adopt a provision for foreign tax credits; prior to the Convention, credits against the United Kingdom tax on account of foreign taxes paid were unknown under British law. Memorandum Prepared for the Committee on Foreign Relations, Hearings p. 29. The United States also made an important concession by providing that the foreign tax credit allowed United States residents on dividends from a United Kingdom corporation includes the United Kingdom standard tax paid by the British corporation. This represents a major departure from the United States tax law, for prior to the Treaty the Commissioner of Internal Revenue had maintained and this Court had held in *Biddle* v. *Commissioner*, 302 U. S. 573 (1938) that an American recipient of a dividend from a British corporation is not "the taxpayer" in respect of the United Kingdom standard tax paid by the corporation, and accordingly was denied any credit on account of such tax.

The Court below argued (R. 26-27) that the technical precision with which such provisions as Article VI (and presumably Article XIII) were drafted indicates that if an exemption had been contemplated under Article XIV for the undistributed gains realized by a trustee, Article XIV would have contained precise language to that effect. This argument overlooks the fundamental difference between the relationship of a stockholder to the corporate assets and the relationship of a beneficiary to property held in trust.[20] This distinction is recognized in the Treaty, where Article II(1)(d) and (e) specifically speak of a corporation

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[20] Compare *Helvering* v. *Hutchings*, 312 U. S. 393 (1941) with *Heringer* v. *Commissioner*, 235 F. 2d 149 (9th Cir. 1956), *cert. denied*, 352 U. S. 927 (1956). See also *Klein* v. *Board of Tax Supervisors*, 282 U. S. 19, 24 (1930): "The corporation is a person and its ownership is a non-conductor that makes it impossible to attribute an interest in its property to its members."

as a separate and distinct entity or juridical person. Thus, within the treaty itself it was necessary to state expressly the intended exceptions to corporate entity rules.

As shown above, the United States exacted important concessions from the United Kingdom in obtaining a breach in the wall of secrecy concerning exchange of information for enforcement purposes and in winning acceptance of mutual credits for foreign taxes. The United Kingdom in turn exacted important concessions in obtaining source exemptions and reciprocity. Reciprocity of treatment in terms of economic burden of tax was the insistent goal of the United Kingdom. It is left to this Court to see that the concessions or commitments on the part of the United States are carried out.

3. The Burden of the Tax Falls Upon the United Kingdom Beneficiaries in the Year of Sale; the Status of the Beneficiaries in the Year of Sale Is Necessarily Controlling.

The burden of tax here is on the Fedden family. The burden undeniably falls upon the remaindermen, for the corpus of the trust is depleted by the amount of the tax. The tax is also a burden upon the life beneficiaries, for the depletion of the corpus necessarily diminishes the income-producing property and so the current income distributable to such beneficiaries.

The trustee acts in a representative or fiduciary capacity only, and has only legal title to the trust property. Equitable ownership has more significance than the naked legal title of a trustee, and this has been recognized in tax disputes. Thus in *Commissioner* v. *Nevius*, 76 F. 2d 109 (2d Cir. 1935), *cert. denied*, 296 U. S. 591 (1935) a life beneficiary of a British trust who was a non-resident alien from our standpoint died holding a power of appointment over her share of the trust property, which consisted in

part of stock in American companies. The issue was whether the decedent "owned and held" the shares of stock in the trust fund, for if so the value of the shares so owned was subject to our estate tax. The United States Court of Appeals for the Second Circuit upheld the tax, saying that the decedent, although having a beneficial interest only in the trust corpus, "owned and held the stock". In the course of his opinion Judge Swan, who wrote for the Court said (p. 110):

> "Equitable interests are so common and so valuable that it is incredible that they should be excluded from taxation. The naked legal title of a trustee during the continuance of the trust has no pecuniary value."

In a concurring opinion Judge Learned Hand said (p. 111):

> "* * * it would, I think, quite contradict the whole scheme of the title to import a distinction between legal and equitable interests, whatever view one takes of equitable interests, whether as no more than rights in personam or as 'property.' Only lawyers make that distinction to-day and not many even of them; it would be pedantic to impute it to Congress, even in a tax statute. Therefore I think that the decedent 'owned and held' the shares at her death and that they were a part of her taxable gross estate."

The present economic burden of the tax would clearly fall on a vested remainderman in the United Kingdom. The equity courts of England and the courts of the United States have clothed the remainderman of a trust with major attributes of ownership of the trust property. An indefeasibly vested remainder is a present estate in being, with only the right of possession and enjoyment postponed until the

trust terminates and the remainder falls in. Where the remainder is defeasible, that is, vested but subject to being divested on a condition subsequent, the remainderman enjoys substantially the same rights with respect to the trust property so long as the remainder continues.

In the present case the gains here are accumulated for the benefit of the issue of the income beneficiary-grantor. Two issue were in being when the taxes were imposed, namely, the grantor's teen-age daughters (R. 16-17) and so long as they live the accumulations in the trust are for them. They were and remain the "presumptive" takers of the trust accumulations. If the death of the children should defeat their interests and if they should die without issue, the trust fund becomes subject to disposal by the grantor as he shall appoint by will or, if he should fail to appoint, according to the laws of intestate succession.

Thus it is clear that the Fedden family as a group or class, all resident in the United Kingdom, are the beneficial owners of the trust corpus and are burdened by the tax imposed in the year of sale. Their interests as a group or class are equivalent to vested remainder interests, with possible shifts of interest within the group or class. Of primary practical significance, however, is the fact that during the years the capital gains taxes were imposed, the two living remaindermen were the presumptive takers of the amounts accumulated for them.

In a case where an income tax is sought to be imposed, little or no significance is attached to nice distinctions among remainder interests, such as vested, contingent or vested subject to being divested. An illustration may be found in *Kent* v. *Rothensies*, 120 F. 2d 476 (3d Cir. 1941), *cert. denied*, 314 U. S. 659 (1941). A grantor created a trust under circumstances permitting the trust income to be taxed to the grantor. One half of the trust income was to be accumulated for two years and at the expiration of

two years was to be distributed to the grantor "if living". The grantor contended that his interest in such accumulated income was contingent and therefore he should not be subject to tax. The Third Circuit dismissed the grantor's contention as follows (at p. 479):

> "The plaintiff [grantor] is not only one of a number of persons to whom distribution may eventually be made but in fact is the presumptive taker of the trust accumulations. As a practical matter, so long as the plaintiff is alive the accumulations of the trust income are for him."

Such a practical approach commends itself in applying an exemption provision in an international treaty, most certainly where it can be shown that such an approach advances the underlying objective of the treaty exemption.[21]

The Court below did not question that there would be a burden on remainder interests, but questioned whether it was sufficiently clear that the burden would fall on United Kingdom residents, stating:

> "* * * [I]t is wholly unclear that the entire economic burden of the tax will fall on United Kingdom residents. Since the tax constitutes a charge on corpus, it will affect the present beneficiary only slightly by reducing the income; and it is difficult to say now that when the ultimate recipients of the corpus take, they will all be residents of the United Kingdom" (R. 28).

However, under our income tax law a capital gains tax can be imposed only in the year of the sale of the capital assets, and the exemption can therefore be applied, if at

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[21] The Tax Court has recently held in *Lambert Tree Trust Estate*, 38 T. C. 392 (1962) that *American Trust Company* v. *Smyth*, *supra*, is not controlling where the remainder interests are contingent in nature.

all, only in the year of sale. An analogous situation exists under Section 642(c) of the Internal Revenue Code, which provides for a deduction for any amount of the gross income of a trust which is "paid or permanently set aside" for charitable purposes. Both the courts and the Treasury interpret Section 642(c) as providing a complete deduction for capital gains set aside for future charitable distribution without any diminution for the value of an intervening life estate and even though at the time of distribution the exempt status of the beneficiary may have changed. *Hopkins v. Commissioner*, 13 T. C. 952 (1949), *appeal dismissed per stipulation* C. C. A. 9, June 19, 1950, 1950 P-H Fed. Tax. Serv. ¶71,098, Regulations §1.642(c)-3, S. M. 4644, V-1 Cum. Bull. 277 (1926), A. R. R. 521, 4 Cum. Bull. 221 (1921).[22] Section 642(c) thus recognizes that notwithstanding the presence of legal title in the trustee, the present owner of any capital gains realized by a trust is the charitable remainderman, who would suffer an immediate economic impact from any tax imposed on these gains.

4. Under the Terms of the Treaty the Exemption for the United Kingdom Beneficiaries Is Not Defeated by the Interposition of a Domestic Trust.

The Court below found that the "technical language" of the Convention, in conjunction with the Internal Revenue Code, "as incorporated by Article II(3)" recognizes a trust as a separate taxable entity (R. 28), since Article II(1)(g) defines a "resident of the United Kingdom" as "any *person* (other than a citizen of the United States or a United States

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[22] Other events could conceivably prevent the charity from receiving the income or capital gains exempted from tax, but those events are also ignored. Such events would include (1) a severe decline in the value of the gross assets of the trust, and (2) unusually large expenses incurred upon the termination of the trust and chargeable to corpus, such as expenses of an accounting proceeding. Moreover, the right of the charity to take the trust property may be defeated by an adverse claimant.

corporation) who is a resident in the United Kingdom for the purpose of United Kingdom tax and not resident in the United States for the purpose of United States tax" (emphasis added), the term "person" is not otherwise defined in the Treaty, and under Section 7701(a)(1) of the Internal Revenue Code of 1954 the term "person" embraces a trust (R. 22-3, footnote 2).

The difficulty with this position is that Section 7701(a) of the Code provides that the term "person shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation." The interplay of Articles II(1)(g) and Article II(3) of the Treaty and our Internal Revenue Code merely state a truism, namely, that the trust is a person and that the individual beneficiaries are persons. The trust is resident in the United States and not resident in the United Kingdom; the beneficiaries are resident in the United Kingdom and not resident in the United States.

In seeking to deny the exemption in this case because the United States trust is a "person", the position of the Court below is virtually the same as the Government's unsuccessful argument in *Helvering* v. *Hutchings, supra,* n. 20.

In the *Hutchings* case, the government sought to permit one gift tax exclusion to a donor who made a gift to a single trust, whereas this Court permitted the donor an exclusion for each of seven beneficiaries of the trust. The government's argument was based on the ground that the statute allowed one deduction for each gift "made to any person" and the statutory definition of "person" embraced a trust. Justice Stone observed that the statutory definition of "person" was of little aid in helping to answer the question before the Court, noting that the Section defining person "means no more than that the

word 'person' in any Section of the act in which it occurs may be taken as meaning 'trust' rather than 'individual' *as the context may require*" 312 U. S. at 395 (emphasis added). In the *Hutchings* case, the equitable owners of the trust property were the beneficial owners of the gift to the trust; the bare legal title of the trustee, or the trust as such, was considered of lesser importance even though the trust was, by statutory definition, a "person".[23]

If there had been a clear intent to permit the "separate existence" of a domestic trust to defeat the exemption by the terms of the Treaty itself, a ready method was at hand. All of the treaties prior to the United Kingdom Convention contained a "saving clause" which had the precise effect sought by the Government in this case.[24] The typical saving clause provides:[25]

> "Notwithstanding any other provisions of this convention, the United States of America in determining the income and excess-profits taxes, including all surtaxes, of its citizens or residents or corporations, may include in the basis upon which such taxes are imposed all items of income taxable under the revenue laws of the United States of America as though this convention had not come into effect."

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[23] By way of contrast, a different rule applies to a gift to a corporation where there is only one gift tax exemption, notwithstanding the indirect proportionate benefits derived from such gift by the stockholders. See *Heringer* v. *Commissioner*, *supra*, n. 20. The concept of a corporation as a separate juridical person or entity is basic in the laws of the United States and England and is expressly recognized in the Treaty definitions.

[24] Sweden, March 23, 1939, 54 Stat. 1767, Art. XIV(a); Canada, March 4, 1942, 56 Stat. 1404, Art. XVII; France, July 15, 1939, 59 Stat. 900, Art. 14A.

[25] Treaty with Sweden, Art. XIV(a). The saving clause is always part of the provision of a treaty granting credits for foreign taxes on a reciprocal basis, and accordingly does not vitiate the foreign tax credit provisions. When the object of a treaty is to eliminate double taxation, the reciprocal credit provision combined with a saving clause adequately serves the purpose.

With the exception of certain of our treaties with English-speaking or Commonwealth countries, all of our treaties have included a saving clause substantially in the form quoted above. In all, sixteen conventions contain the standard saving clause.[26] The six other conventions contain language substantially identical to the definitional provisions of Article II of the United Kingdom Convention.[27] In most instances the definitional provisions of Article II of the United Kingdom Convention have the same effect as the standard saving clause found in the other conventions. Thus, the definition of "resident of the United Kingdom" in Article II(1)(g) specifically excludes from its coverage "a citizen of the United States" and "a United States corporation", or, stated differently, includes: "any person (other than a citizen of the United States or a United States corporation) who is a resident in the United Kingdom for the purposes of United Kingdom tax and not resi-

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[26] Austria, Oct. 25, 1956 [1957] 2 U. S. T. & O. I. A. 1699, 1708, Art. XV(1); Belgium, Oct. 28, 1948 [1953] 2 U. S. T. & O. I. A. 1647, 1622, Art. XII(1); Canada, *supra* n. 24 Art. XVII; Denmark, May 6, 1948, 62 Stat. 1730, 1735, Art. XV(a); Finland, March 3, 1952 [1952] 3 U. S. T. & O. I. A. 4485, 4492, Art. XV(1)(a); France, *supra* n. 24 Art. 14A; Germany, July 22, 1954 [1954] 3 U. S. T. & O. I. A. 2768, 2798, Art. XV(1)(a); Greece, Jan. 20, 1950, [1954] 1 U. S. T. & O. I. A. 47, 69, Art. XIV(1); Honduras, June 25, 1956, [1957] 1 U. S. T. & O. I. A. 219, 228, Art. XVI(1)(a); Italy, March 30, 1955 [1956] 3 U. S. T. & O. I. A. 2999, 3011, Art. XV(1)(a); Japan, April 16, 1954 [1955] 1 U. S. T. & O. I. A. 149, 162, Art. XIV(a); Netherlands, April 29, 1948, 62 Stat. 1757, 1764, Art. XIX(1); Norway, June 13, 1949 [1951] 2 U. S. T. & O. I. A. 2323, 2329, Art. XIV (1)(a); Sweden, *supra* n. 24 Art. XIV(a); Switzerland, May 24, 1951 [1951] 2 U. S. T. & O. I. A. 1751, 1759 Art. XV(1)(a); Union of South Africa, Dec. 13, 1946 [1952] 3 U. S. T. & O. I. A. 3821, 3825, Art. IV(1).

[27] Australia, May 14, 1953 [1953] 2 U. S. T. & O. I. A. 2274, 2277, Art. II(1)(f); India, Nov. 10, 1959, Department of State Release Number 783 (Ratification Pending), Art. II(1)(b); Ireland, Sept. 13, 1949 [1951] 2 U. S. T. & O. I. A. 2303, 2307, Art. II(1)(g); New Zealand, March 16, 1948 [1951] 2 U. S. T. & O. I. A. 2378, 2380, Art. II(1)(j); Pakistan, July 1, 1957 [1959] 1 U. S. T. & O. I. A. 984, 986, Art. II(1)(i); United Kingdom, Art. II(1)(g).

dent in the United States for purposes of United States tax."

There is nevertheless a marked difference between the standard saving clause and the definitional provisions found in Article II of the Treaty.

The standard saving clause would expressly provide that the United States may tax the capital gains of a United States trust "notwithstanding any other provisions of this Convention" (Article XIV in this case), and "as though this Convention had not come into effect". The standard saving clause would extinguish the exemption of Article XIV in any consideration of this case. The exemption is not extinguished by the definitional provisions in Article II of the United Kingdom Treaty and such provisions have no similar overriding power.

Under the Treaty, any term not otherwise defined shall have the meaning given it by the laws of the country which is applying the Treaty to a question of domestic taxation "unless the context otherwise requires". Whether the term "person", with reference to "resident of the United Kingdom" means a trust without regard to the status of the beneficiaries, or the individuals who are beneficiaries without regard to the status of the trust, necessarily depends upon the context in which it is found. For example, Articles VI, VII, VIII and IX of the Treaty deal, respectively, with dividends, interest, copyright and trademark royalties and mineral royalties. In each case, the United States domestic rules of taxation give way to the treaty provisions if the item of income is "derived by" a resident of the United Kingdom "who is subject to tax on" or "with respect to" such income. If such items of income are accumulated in a domestic trust for future distribution to United Kingdom beneficiaries, it would appear, in the context of those treaty provisions, that the United Kingdom

beneficiaries are not the persons to whom such provisions were intended to apply. However, similar language is absent from Article XIV, even though in large part found in the capital gain provisions of the three treaties entered into before the United Kingdom treaty was secured.[28]

In contrast to such other provisions, the broad mandate of Article XIV invites a liberal construction if its underlying purpose is to be achieved.

It is of course true that in a technical sense the trust in this case is the "taxpayer", but the beneficiaries bear the burden of the tax, and only in a narrow technical sense has "exempt from United States tax" any substantive bearing on the domestic trust. This Court has refused to apply a technical meaning to a tax exemption when the circumstances justified a liberal meaning.

Prior to the allowance of any deduction in respect of the income of a trust or estate "permanently set aside" for a charity, the question arose whether the income of a testamentary trust, which income would pass to a tax-exempt hospital upon the death of an annuitant, was exempt (the statutory language was "shall not be taxed"). *Lederer v. Stockton* 260 U. S. 3 (1922). The Supreme Court of Pennsylvania had held that the income on the bequest could not be paid to the charity until the death of the annuitant, and that until such event occurred the income must remain in the control of the trustee under the will. Faced with this situation, the trustee transferred the entire bequest as a loan to the hospital secured by a mortgage on the hospital property, under the terms of which the hospital would pay only interest enough to satisfy the administrative charges and the remaining annuity, using the remain-

[28] In each of the prior treaties, the gain must have been derived from the sale or exchange of capital assets by a resident of the other state. See *supra*, pp. 18-19.

der for its own purposes. The government contended that the trust as interpreted by the Supreme Court of Pennsylvania was an active trust and one which could not be terminated, and accordingly the income in question was not "income received" by a charity and so not within the exemption. Nevertheless, this Court held that the income was not subject to tax.

This Court analyzed our domestic scheme of taxing trust income in *Helvering* v. *Butterworth*, 290 U. S. 365 (1933), and *Freuler* v. *Helvering*, 291 U. S. 35 (1934). Congress, it was said, did not intend that any income from a trust should escape taxation. But in the *Butterworth* case this Court added significantly "unless definitely exempted" 290 U. S. at 369. Our scheme of taxing trusts insures that taxable income is taxed at least once, either to the beneficiary if the income is currently distributed or distributable, or to the trust if the income is accumulated for future distribution. A trust, however, does not change the character of the income that is screened through it.[29] A trust does not create a tax on income that is intended to be exempt.

While the separate entity concept of a trust is repeatedly brushed aside in domestic tax controversies, examples can be found where the separate existence of an estate or trust and literal provisions of the Code have been magnified to the extreme. The Tax Court adopted such an approach

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[29] This rule is now a part of the Internal Revenue Code, Sections 643, 652 and 662, but it antedated express statutory provisions. Thus in *Helvering* v. *Falk*, 291 U. S. 183 (1934), this Court allowed the beneficiaries of a trust a deduction for percentage depletion on mineral property held by the trust even though, as the government argued, the statute required the beneficiaries to include the entire distribution from the trust in income and made no provision for the allowance to the beneficiaries of a deduction with respect to property held by the trust.

in *Estate of Emily St. A. Tait*, 11 T. C. 731 (1948),[30] but since the approach quite obviously defeated a treaty exemption, the Treasury issued a ruling repudiating the Tax Court decision in the case, stating (I. T. 4019, 1950-2 Cum. Bull. 58, 60):

> "To disallow the deductions in such cases would have the effect of taxing income which is specifically exempted by Treaty.
>
> * * * if the income is 'definitely exempted' by treaty provisions, effect must be given to such provisions."

5. Since Congress Adopted the Treaty Exemption Unconditionally and Without Limitation, the Exemption Should Be Construed so as to Secure the Intended Equality and Reciprocity of Treatment.

We are dealing not only with an exemption granted by an international treaty, but also with that same exemption expressly implemented by Congress in a manner sufficient to resolve conflicting rules of domestic tax law in favor of the Treaty exemption.

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[30] The petitioner in the *Tait* case, an American ancillary administrator of a Canadian estate, had made annuity payments to Canadian residents, who were exempt by Treaty from United States tax on pension income, and claimed as a deduction in the fiduciary return the amount of such payments. The Tax Court held the estate taxable on the income received and paid to the annuitants and denied deduction of the annuity payments, since, under Section 162 of the Internal Revenue Code of 1939, the "amount so allowed as a deduction shall be included when computing the net income of the beneficiary", citing *Helvering* v. *Butterworth*, *supra*, to the effect that "the income of an estate is to be taxed to either the fiduciary or the beneficiary distributee, and that it may not be permitted to escape tax by falling in some way between the two". The technical effect of the decision was to impose the tax, not on the distributee who was exempt under the Treaty, but upon the trustee, who was not exempt. Following an appeal, taken by the taxpayer to the United States Court of Appeals, the case was remanded to the Tax Court by stipulation by both parties. (C. C. A. 4, 1949 P-H Fed. Tax Serv. ¶71,107). Pursuant to stipulation of the parties, the Tax Court entered a final decision of no deficiency. (1949 P-H Fed. Tax. Serv. ¶74,290).

Section 894 of the Internal Revenue Code of 1954, 26 U. S. C. §894, provides: "Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle." Thus, unconditionally and without limitation, our Internal Revenue Code exempts from taxation income of any kind and to the extent required by any treaty obligation. This provision was first enacted in 1936, and has since remained intact in our otherwise everchanging revenue laws.

Congress has not rested on this blanket incorporation of treaty exemption for "income of any kind", and "to the extent required" by any treaty obligation. Congress expressly provided, in Section 7852(d) of the Internal Revenue Code of 1954:

> "No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title." 26 U. S. C. §7852(d).

The treaty exemption overrides domestic tax rules, and is intended by Congress to be upheld as found in the four corners of the treaty itself.

Since both treaties and acts of Congress are the supreme law of the land, this Court has endeavored to construe them, where they relate to the same subject, so as to give effect to both, if that can be done without violating the language of either. There is no need here, however, to weigh domestic concepts in an effort to narrow a construction of Article XIV, since Congress has eliminated concern as to conflict with domestic law by enactment of Internal Revenue Code Sections 894 and 7852(d).

The interpretation of Article XIV should therefore be governed by the repeatedly enunciated principle that a

treaty should be liberally construed so as to carry out the objectives of the contracting parties. In *Geofroy* v. *Riggs*, *supra*, p. 13,[31] this Court said (132 U. S. at 271):

> "It is a general principle of construction with respect to treaties that they shall be liberally construed, so as to carry out the apparent intention of the parties to secure equality and reciprocity between them. As they are contracts between independent nations, in their construction words are to be taken in their ordinary meaning, as understood in the public law of nations, and not in any artificial or special sense impressed upon them by local law, unless such restricted sense is clearly intended. And it has been held by this court that where a treaty admits of two constructions, one restrictive of rights that may be claimed under it and the other favorable to them, the latter is to be preferred."

See also *Hauenstein* v. *Lynham*, 100 U. S. 483 (1879); *In re Ross*, *supra*, p. 19; *Jordan* v. *Tashiro*, 278 U. S. 123 (1928); *Factor* v. *Laubenheimer*, 290 U. S. 276 (1933).

As stated by this Court more recently, "This Court has many times set its face against treaty interpretations that unduly restrict rights a treaty is adopted to protect." *Kolovrat* v. *Oregon*, 366 U. S. 187, 193 (1961).

The Ninth Circuit in the *American Trust Company* case embraced a liberal construction of Article XIV in order to

[31] In *Geofroy* v. *Riggs*, a treaty between the United States with France insured equality between the nationals of the two countries with respect to the possession and disposal of personal and real property "in all the states of the union", and, with respect to France, "within its territories". The claimant, a citizen of France, asserted the right to inherit real estate in the District of Columbia. Unless the phrase "states of the union" included such political bodies as the District of Columbia and our territories, full reciprocity would not be attained. This Court held that the phrase "states of the union" embraced the District of Columbia.

carry out the apparent intention of the parties to secure equality and reciprocity between the parties to the Convention. *American Trust Company* v. *Smyth*, 247 F. 2d at 152-53. The decision in the *American Trust Company* case achieves reciprocity. The decision of the Court below does not.

II.

The Treasury Regulations Fail to Deal With the Unique Terms of the United Kingdom Treaty, Lack Express Sanction in the Treaty, and Should Not Be Given Controlling Weight.

In reaching its conclusion that the gains in this case are taxable, the Court below also relied upon the Treasury Regulations interpreting the Treaty. T. D. 5569, 1947-2 Cum. Bull. 100, §7.519(c), (R. 28-29).

Section 7.519 of the Regulations, which purports to determine the extent to which gains in trust are eligible for the Article XIV exemption, provides:

> "(c) Beneficiaries of an estate or trust.—A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, provided in Articles VI, VII, VIII, IX and XIV of the convention with respect to dividends, interest, royalties, natural resource royalties, rentals from real property and capital gains to the extent such item or items are included in his distributive share of income of such estate or trust if he is taxable in the United Kingdom on such income and is not engaged in trade or business in the United States through a permanent establishment." T. D. 5569, 1947-2 Cum. Bull. 100 at 114.

These regulations contain a patent defect. It is stated that a United Kingdom resident "who is a beneficiary of a domestic trust" shall be entitled to the exemption or reductions in the rate of tax with respect to "dividends, interest, royalties, natural resource royalties, rentals from real property and capital gains" when such items are included in his distributed share "if he is taxable in the United Kingdom on such income and is not engaged in trade or business in the United States through a permanent establishment". Capital gains realized by a trust are not subject to tax in the United Kingdom, whether the trust is a United Kingdom trust or a United States trust. Thus, the qualifying clause "if he is taxable in the United Kingdom on such income", while appropriate in the case of the other recited items, is entirely inappropriate in respect to a capital gain. Indeed the treaty itself imposes the same limitation with the sole exception of capital gains under Article XIV.

Similarly, the requirement that capital gains must be included in the beneficiary's distributive share of the income of a trust appears nowhere in Article XIV. While this requirement is reasonable in the case of dividends, interest, royalties and rentals, which almost always constitute income in the trust accounting sense, it would render Article XIV largely inoperative in the case of capital gains, which are normally treated as items of trust corpus accumulated for the benefit of the remainderman.

The Court below made no reference to these considerations, perhaps because, to use its own words (R. 29):

> "A similar position recognizing that the trust is a separate taxable entity for the purpose of determining treaty exemptions has been taken in the interpretation of all our tax conventions."

However, as we have shown above, most of these other treaties contain quite different language, so that their interpretation is in no respects controlling here.

One other provision of T. D. 5569 is also pertinent. Section 7.514 sets forth the specific classes of income from sources within the United States which are considered exempt under the Convention. Among these are:

> "(g) Gains from the sale or exchange of capital assets by a nonresident alien who is a resident of the United Kingdom or by a foreign corporation managed and controlled in the United Kingdom, if such alien or corporation has no permanent establishment in the United States (Article XIV);" T. D. 5569, 1947-2 Cum. Bull. 100 at 110.

See also Section 7.523.

This subparagraph is appropriate when applied in the case of property directly owned by a resident of the United Kingdom. It does not undertake to apply to property held in trust, which is specifically dealt with in Section 7.519(c). But if Section 7.514(g) were considered as having general application, its limited language, "Gains from the sale * * * of capital assets by a nonresident alien", does not reflect the broad language of Article XIV, "A resident of the United Kingdom * * * shall be exempt from United States tax on gains from the sale * * * of capital assets". Instead Section 7.519(c) reflects the quite different language of the three earlier treaties and is the same as the Regulations under those treaties.[32] However, it is certainly not fully responsive to the language of the treaty exemption provided by Article XIV.

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[32] Canada, T. D. 5206; Sec. 7.21(f), 1943 Cum. Bull. 526, 534; France, T. D. 5499, Sec. 7.412(g), 1946-1 Cum. Bull. 134, 142; Sweden, T. D. 4975, Sec. 25.1(d), 1940-2 Cum. Bull. 43, 51.

It is significant that the Regulations under the United Kingdom Treaty were not issued pursuant to any authority granted by that Treaty, but instead were promulgated under the general power granted to the Commissioner under Section 62 of the 1939 Code, 53 Stat. 32, (the predecessor of 1954 Code Section 7805, 26 U. S. C. §7805) to issue regulations "for the enforcement of the chapter", namely, the income tax chapter of the Internal Revenue Code. This is important since all of the three tax treaties which were ratified by the United States prior to the ratification of the United Kingdom Treaty contain express authority for the prescription of regulations, so that the regulations under those treaties thus have the express sanction of the treaties themselves.[33] While the courts have given great weight to the administrative regulations under these treaties,[34] the absence of any similar provision under the United Kingdom Treaty makes it appropriate to view with skepticism any regulation promulgated solely under the authority of our domestic law which takes a restrictive view of the rights granted to United Kingdom residents by a compact between two sovereign states.

This Court in the past has refused to follow tax regulations when to do so would "create a rule out of harmony with the statute." *Manhattan General Equipment Co.* v. *Commissioner*, 297 U. S. 129, 134 (1936). See also *Commissioner* v. *Acker*, 361 U. S. 87, 92 (1959), *United States*

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[33] Treaty between the United States and Sweden, March 23, 1939, 54 Stat. 1773, Art. XXI; Treaty between the United States and Canada, March 4, 1942, 56 Stat. 1405, Art. XVIII; Treaty between the United States and France, July 25, 1939, 59 Stat. 908, Art. 26, (superseded by Art. 1[illegible] of Supplemental Convention, October 18, 1946, 64 Stat. B21). Of the seventeen United States tax treaties ratified since the United Kingdom Treaty, fifteen contain specific language authorizing the promulgation of regulations.

[34] *E.g. Lewenhaupt* v. *Commissioner*, 20 T. C. 151 (1953), *aff'd per curiam*, 221 F. 2d 227 (9th Cir. 1955).

v. *Calamaro,* 354 U. S. 351, 359 (1957) and *Trust of Bingham* v. *Commissioner,* 325 U. S. 365, 376-377 (1945). Similarly, the Regulations involved in this case would create a rule which is unresponsive to the broad mandate of Article XIV, and hence should not be given controlling weight.

Conclusion.

The judgment of the Court of Appeals should be reversed and the decision of the District Court affirmed.

Respectfully submitted,

D. Nelson Adams,
David A. Lindsay,
John A. Reed,
John A. Corry,
Attorneys for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

Of Counsel:

Davis Polk Wardwell Sunderland & Kiendl,
Hill Betts Yamaoka Freehill & Longcope.

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In the Supreme Court of the United States

OCTOBER TERM, 1962

No. 240

ANDRE MAXIMOV, ETC., PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the district court (R. 17–18) is not reported. The opinion of the court of appeals (R. 20–30) is reported at 299 F. 2d 565.

JURISDICTION

The judgment of the court of appeals (R. 30) was entered on February 14, 1962. On May 8, 1962, by order of Mr. Justice Harlan, the time for filing a petition for certiorari was extended to and including July 14, 1962 (R. 31). The petition was filed on July 10, 1962, and was granted on October 8, 1962 (R. 32). The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

677302—63——2

QUESTION PRESENTED

Whether nondistributable capital gains realized and retained by an American trust whose beneficiaries are citizens and residents of the United Kingdom are exempted from United States income tax by Article XIV of the Income Tax Convention between the United States and the United Kingdom, which exempts capital gains of a "resident of the United Kingdom."

CONVENTION, STATUTES AND REGULATIONS INVOLVED

The Income Tax Convention between the United States and the United Kingdom, 60 Stat. 1377, is set forth in the separately-bound Appendix to Petitioner's Brief (Pet. App. A1–A21). Portions of Sections 641, 642, 643, 651, 652, 661 and 662 of the Internal Revenue Code of 1954, pertaining to the taxation of domestic trusts, are set forth at Pet. App. A23–A27. Sections 507.10, 507.103, 507.108, 507.112 of the Treasury Regulations under the Convention with the United Kingdom are set forth in the Appendix, *infra*, pp. 28–31.

STATEMENT

The petitioner is a private trust, established in Connecticut under a deed of trust dated October 24, 1947, by H. Robbin Fedden (R. 10–15). The grantor, who is also life-income beneficiary, was at all relevant times a citizen and resident of the United Kingdom, as were his wife, Renee, who is contingent successor life-income beneficiary,[1] and his children, Katharine

[1] The contingencies as to the wife were (1) that she survive the grantor (R. 11); (2) that she be married to the grantor at his death (R. 11); (3) that the trust should not have been

and Frances, who are contingent remaindermen [2] (R. 16–17).

Andre Maximov is the successor trustee (R. 14, 15–16). He is a citizen and resident of the United States (R. 2, 4, 6). During 1954 and 1955 the trust sold securities and realized capital gains which were retained and added to corpus (R. 5, 7), as required by controlling Connecticut law.[3] The trustee reported these gains as part of the trust's income and paid the federal income tax thereon in the amounts of $53.10 for 1954 and $1,316.32 for 1955 (R. 2–3, 4–5, 6–8, 8–9). Thereafter the trustee filed claims for refund of the capital gains tax so paid, alleging exemption under Article XIV of the Income Tax Convention between the United States and the United Kingdom (R. 4–8). When they were disallowed (R. 3, 8), he filed suit on October 28, 1959, in the United States District Court for the Southern District of New York (R. 1–3).

On cross motions for summary judgment, the district court, following the decision of the Court of Appeals for the Ninth Circuit in *American Trust*

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terminated by the grantor prior to his death (R. 15); and (4) that the trust should not have been exhausted through exercise by the trustee of his discretionary power to pay over principal (R. 11).

[2] The contingencies as to the children were (1) that they survive their parents (or at least their father, if their parents are not marrried at the father's death) (R. 11); (2) as to a portion of their respective interests, that the grantor should have no later born children; (3) and (4), the same contingencies as for the grantor's wife (see note 1, *supra*).

[3] See Conn. Gen. Stat. Ann., § 45–112. The trust instrument expressly provides that Connecticut law shall govern (R. 14).

Company v. *Smyth*, 247 F. 2d 149, denied the government's motion and granted the plaintiff's motion (R. 17-18). Judgment for the plaintiff in the full amounts claimed was subsequently entered (R. 19). On appeal by the United States, the Court of Appeals for the Second Circuit reversed (R. 21-30).

SUMMARY OF ARGUMENT

A. Article XIV of the Income Tax Convention between the United States and the United Kingdom exempts, from the United States tax on capital gains, only British residents. The petitioner trust, as an American resident for tax purposes, does not qualify. And, while the English beneficiaries satisfy the residence requirement, as to the capital gains retained by the trust they are not the taxpayer.

The suggestion that the trust should be ignored and the beneficiaries viewed as the direct recipients of the income finds no support in the language of the Convention. It is at war with the American tax system which rejects economic burden concepts and treats the trust as a distinct juridical personality, separately taxable on its own retained income. The Convention does not purport to override our revenue laws in this respect. On the contrary, there is explicit deference to the local law of the taxing government in the interpretation of undefined terms. In any event, the rule favoring accommodation between treaties and domestic law requires rejection of the present claim. Whatever doubts exist must be resolved against the taxpayer who asserts, at best, an implied exemption.

B. The history of the Convention confirms our reading of Article XIV. The Article was accepted here only reluctantly, in a climate of growing hostility toward exemptions for nonresident aliens. Ratification was based on the precedent of earlier tax treaties which had been interpreted as denying exemption to capital gains retained by an American trust with foreign beneficiaries and on explicit assurances that the British treaty would confer no wider exemptions.

There is nothing to suggest that the Convention was meant to affect domestic taxation of local residents. On the contrary, every indication is that the two governments were concerned only with *international* problems of double taxation and fiscal evasion, matters wholly foreign to this dispute.

C. The American regulations promulgated under the Convention reject petitioner's claim. It seems clear they were approved by the British government before issuance. In any event, having been in effect for more than sixteen years with the acquiescence of both governments, the presumption is that the regulations correctly interpret the Convention.

ARGUMENT

ARTICLE XIV OF THE INCOME TAX CONVENTION WITH THE UNITED KINGDOM DOES NOT EXEMPT NONDISTRIBUTABLE CAPITAL GAINS REALIZED AND RETAINED BY AN AMERICAN TRUST WHOSE BENEFICIARIES ARE CITIZENS AND RESIDENTS OF THE UNITED KINGDOM

It is conceded that, absent Article XIV of the Income Tax Convention with the United Kingdom

(Pet. App. A-1, A-13), the petitioner trust itself,[4] having retained the gains, would owe the contested tax notwithstanding that the beneficiaries are all nonresident aliens. But the treaty, it is said, works an exemption and relieves the trust of this obligation.[5]

The provision invoked stipulates:

> A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

On its face, Article XIV obviously does not exempt the present trust, at least directly. For the American trust is plainly not a "resident of the United Kingdom." The contention is, however, that the British beneficiaries, albeit they themselves owe no tax on the transactions in question, are exempted, and that, through them, the American trust is excused from its tax liability. The argument is that "exempt" in this context does not mean exonerated from *paying* the tax, but, rather, relieved of the *ultimate economic burden* of the tax.

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[4] Petitioner has never claimed that the capital gains were taxable to the grantor, rather than the trust, under the special provisions of Sections 671-677 of the 1954 Code, 26 U.S.C. 671-677. Quite properly, he now agrees that the argument is foreclosed (Br. 4, n. 1).

[5] Of course, if the capital gains involved are exempt under the treaty, they are exempt under our law. Sec. 22(b)(7), 1939 Code; Secs. 894, 7852(d), 1954 Code. Whether the treaty overrules domestic law in this respect is, however, the very issue in this case. Cf. Pet. Br. 37.

Petitioner's reading of Article XIV is, at best, a strained construction of the text. Nothing requires it. On the contrary, we will show that the language, the history, and the contemporaneous interpretation of the Convention compel a rejection of the argument.

A. THE TEXT OF THE CONVENTION FORECLOSES THE CLAIM OF EXEMPTION.

At the outset, it is apparent that Article XIV of the United Kingdom Convention exempts *persons,* not income as such. It is the "resident of the United Kingdom" who is exonerated "from the United States tax;" the capital gains themselves are not granted immunity from taxation because of their character, or their source. Accordingly, the provision is inapplicable unless some person qualifies to claim the exemption.

Certainly, the taxpayer-trust itself is not a "resident of the United Kingdom" by virtue of its British beneficiaries. The Convention itself makes this clear in Article II(1)(g) (Pet. App. A3) which defines a British resident as a "person * * * who is resident in the United Kingdom for the purposes of United Kingdom tax" and, at the same time, is "not resident in the United States for the purposes of United States tax." The present trust fails to qualify on both grounds. There is no suggestion that the British government views the petitioner trust as a British resident for tax purposes. Nor does our law consider a trust created and administered in the United States a nonresident for tax purposes merely because its beneficiaries are residing abroad. On the contrary, under our tax laws a trust is a separate taxable entity, apart from its

beneficiaries. Secs. 161, 3797(a)(1), 1939 Code; Secs. 641, 7701(a)(1), 1954 Code. And, whatever the test for determining the residence of a trust, the question is resolved without noticing the domicile of the beneficiaries. See Rev. Rul. 62-154, I.R.B. 1962-38, p. 8. Plainly, the petitioner trust, established in the United States, governed by American law, and locally administered by an American trustee, is deemed a domestic trust for tax purposes.

The beneficiaries, then, must claim the exemption in their own right. As British citizens and residents, they qualify. But they are not the recipients of the gains at the time the exemption is claimed. Nor are they liable for the related tax. Yet, Article XIV, on its face, seems to deal with the British resident only with respect to *his own* income and *his own* tax liability. Indeed, the natural implication of saying that someone "shall be exempt * * * from tax" is that he was previously subject to the tax and is now relieved from paying it. In short, Article XIV would seem to have no application to residents of the United Kingdom who are not otherwise American taxpayers.

The result seems obvious. Since the beneficiaries neither received the capital gains nor owed the tax attributable to the transactions, there is no occasion to exempt them. And, since the trust itself is not a resident of the United Kingdom, it does not qualify for the exemption conferred by Article XIV of the Convention. Petitioner, however, does not recognize the impasse. In search of an exit, he imagines a middle road where trust and beneficiaries are con-

fused. The argument has several variants, but they all founder in the attempt to "pierce the fiduciary veil."

It is argued, for instance, that since the United Kingdom Convention does not expressly advert to trusts, it views the beneficiaries as the true recipients of the trust income, whether or not it is distributed to them. Thus, according to petitioner, the term "resident" in the Convention includes only natural persons and corporations; yet, the Convention certainly applies to the income of private trusts; therefore, its provisions must be read as ignoring the trust "fiction" and treating the income of a trust (whether or not retained) as the income of the individual beneficiaries.

We might answer that the same argument equally sustains the conclusion that the individual *legal* owner—the trustee—is the recipient of the trust income. But the fact is that the Convention recognizes the trust itself as a separate taxable entity. "Resident" is nowhere restricted to natural persons and corporations. On the contrary, as already noted, Article II(1)(g) of the treaty excludes from the definition of "resident of the United Kingdom" "*any person* * * * who is * * * resident in the United States *for the purposes of United States tax*," and the American tax law views a trust as a separate taxable "person."[6]

[6] Article II(1)(g) itself plainly justifies reference to American tax law to determine who are "resident persons" for tax purposes. But any doubt is resolved by Article II(3) (Pet. App. A5) which permits the taxing government to interpret any undefined term—the word "person" not being defined in the treaty—in accordance with its own laws, "unless the context otherwise requires."

(Emphasis added.) Sec. 3797(a)(4), 1939 Code; Sec. 7701(a)(1), 1954 Code.[7]

Failing in this technical approach, petitioner makes a more direct assault on the text of the treaty. He boldly asserts that the exemption conferred by Article XIV does not merely lift the direct tax liability of the British beneficiaries (there being none in the premises), but relieves them of the *indirect* effects of the tax as well. The difficulties remain insurmountable.

In the first place, as already noted, the contention flies in the face of the text invoked, which only exempts the British resident "from United States tax," and does not purport to relieve from the ultimate economic burden of the tax. More fundamentally, the application of an economic burden test in determining exemptions would contradict the whole scheme of trust taxation in the United States, a result neither required nor suggested by the language of the Income Tax Convention. Indeed, even assuming the scope of the exemption is unclear in the text, Article II(3) of the treaty, as we have already noted (see note 6, *supra*), expressly permits the taxing government to resolve ambiguities in accordance with its own laws.

The general rejection of economic burden concepts in American tax law is well settled. The classic state-

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[7] The British also treat trusts as separate taxable entities, although, as might be expected, their treatment apparently differs in detail from ours. Harvard Law School, World Tax Series, Taxation in the United Kingdom, par. 5/3.4; see also, generally, Koch, Double Taxation Relief on Trust Income, 1958 British Tax Rev. 272.

ment of the principle was given twenty-five years ago by Mr. Justice Stone in *Biddle* v. *Commissioner,* 302 U.S. 573, 581. In a related context, the Court there rejected a claim by the stockholder of a British corporation who argued that he was entitled to a credit for the British tax "appropriate" to his dividends but paid by the corporation because the "economic burden" of the levy fell on him:

> Our revenue laws give no recognition to that conception. Although the tax burden of the corporation is passed on to its stockholders with substantially the same results to them as under the British system, our statutes take no account of that fact in establishing the rights and obligations of taxpayers. * * * Nor have they treated as taxpayers those upon whom no legal duty to pay the tax is laid. Measured by these standards our statutes afford no scope for saying that the stockholder of a British corporation pays the tax which is laid upon and collected from the corporation, and no basis for a decision that § 131 extends to such a stockholder a credit for a tax paid by the corporation—a privilege not granted to stockholders in our own corporations. * * *

Cf. *Klein* v. *Board of Supervisors,* 282 U.S. 19, 24.*

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* The intergovernmental immunity cases also emphasize the characteristic of our tax law in which the legal incidence of the tax is controlling. See, *e.g., Alabama* v. *King & Boozer,* 314 U.S. 1, 8-9; *Curry* v. *United States,* 314 U.S. 14, 18; *Helvering* v. *Gerhardt,* 304 U.S. 405, 417, 420-423; *Graves* v. *N.Y. ex rel. O'Keefe,* 306 U.S. 466, 480-481, 484; *Oklahoma Tax Comm'n* v. *Texas Co.,* 336 U.S. 342, 363-364; and compare *Kern-Limerick, Inc.* v. *Scurlock,* 347 U.S. 110, 122, where the legal inci-

Specifically, our tax laws reject the economic burden notion with respect to the taxation of trusts. We have already noted the independent identity of trusts for tax purposes. With a single exception not here relevant,[9] they are taxed without regard to the citizenship, residence, or tax status, of the beneficial owners. See Secs. 161–164, 1939 Code; Secs. 641–668, 1954 Code.[10] With particular reference to capital trans-

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dence of the tax was found to fall directly upon the United States.

Theoretical economic distinctions between "direct" and "indirect" taxes are irrelevant in the present context. See, *e.g.*, Rolph, *The Theory of Fiscal Economics*, p. 80, and Dalton, *Principles of Public Finance*, pp. 23–24, 36 *et seq.* The question here is one of law and not of economics. See *Home Savings Bank* v. *Des Moines*, 205 U.S. 503, 519.

[9] The exception relates to trust income "permanently set aside" for designated eleemosynary purposes. Sec. 162(a), 1939 Code; Sec. 642(c), 1954 Code.

[10] We are entirely consistent in our treatment of a trust as a taxable entity separate from its beneficiaries. Thus, if a United Kingdom trust, not having a permanent establishment in the United States, derives capital gains (or dividends, interest, royalties, rents or the like) from United States sources, and such gains are not distributable to the beneficiaries, but are to be added to the corpus, they would be exempt from United States tax under Article XIV, in spite of the fact that the beneficiaries are not residents of the United Kingdom and the further fact that, if such capital gains were included in the distributive share of the beneficiaries, they would clearly not be exempt under Article XIV. See, *e.g.*, Regulations Secs. 507.2(a), (c), (d)(4); 507.3(a)(1), (a)(4); 507.4(a), (c); 507.5(a), (c); 507.8 (compare Sec. 507.10); 507.103(e); 507.104(b)(4); 507.108(a)(1)(i), (c)(1), 26 C.F.R. 507, *et seq.* See also Rev. Rul. 56-30, 1956-1 Cum. Bull. 646, where an American beneficiary of an Australian trust deriving income from sources within the United States was held exempt from federal income tax on that portion of the income withheld by the trustee and added to corpus. It should be mentioned that Section 7 of the Revenue Act of 1962, P.L. 87-834, 76 Stat. 960, adds

actions, the rule is clear. As long ago as *Anderson* v. *Wilson*, 289 U.S. 20, 26-27, the Court rejected an economic burden argument offered in support of the beneficiary's claim for a personal deduction on account of a capital loss incurred by the trust:

> We hold that the trust, and not the taxpayer, has suffered the loss * * *, and it follows that where loss has not been suffered, there is none to be allowed. * * * In so ruling we do not forget that the trust is an abstraction, and that the economic pinch is felt by men of flesh and blood. Even so, the law has seen fit to deal with this abstraction for income tax purposes as a separate existence, making its own return under the hand of the fiduciary and claiming and receiving its own appropriate deductions. * * * The argument will not hold that what was lost to this taxpayer was not the capital of the trust, but rather his own capital, withdrawn from his possession, but held for his account by the executors as custodians or bailiffs. His capital was in the proceeds, to the extent that they were distributed, and never in the land. * * *

The rule is the same with respect to capital *gains* retained by the trust and added to corpus. They are taxed to the trust, without noticing the beneficiaries. Secs. 161(a) and 162(b), 1939 Code; Sec. 643(a), 1954 Code. And that remains true even when, as here, the

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several new provisions to the 1954 Code to foreclose some of the tax avoidance opportunities theretofore available through the creation by American taxpayers of foreign trusts accumulating income abroad. These new provisions recognize the validity of the Treasury's position but change the law for the future.

beneficiaries themselves are exempt as nonresident aliens. See, *e.g.*, G.C.M. 10423, XI-2 Cum. Bull. 123 (1932); O.D. 743, 3 Cum. Bull. 203 (1920).

The language of the treaty gives every indication that this postulate of our tax laws was to continue undisturbed. Certainly nothing in the use of the term "exempt" suggests the application of an economic burden test. In our revenue laws that word, as applied to a juridical person,[11] intends relief for the potential taxpayer alone, no one else. See, *e.g.*, Secs. 101 and 165, 1939 Code; Secs. 501(a) and 521(a), 1954 Code. There is no pretext for expanding its meaning in the Income Tax Convention. On the contrary, every effort should be made to accommodate the treaty and our domestic law. *United States* v. *Lee Yen Tai*, 185 U.S. 213, 221-222; *Whitney* v. *Robertson*, 124 U.S. 190, 194; *Chew Heong* v. *United States*, 112 U.S. 536, 550.

We conclude that the text is clear. Permissible reference to our domestic law erases every possible doubt. But, even if we overstate the case, petitioner's reading of Article XIV must be rejected under the rule that "those who seek an exemption from a tax must rest it on more than a doubt or ambiguity." *United States* v. *Stewart*, 311 U.S. 60, 71.

[11] More often, especially under the 1939 Code, the term applies to a particular category of income, with more emphasis on the source than the identity of the recipient. See, *e.g.*, Secs. 22(b), 115(b) and 212(b), 1939 Code; cf. Sec. 894, 1954 Code. These uses are not properly comparable. Yet, even there, there is no implication that exemptions look beyond the potential taxpayer.

B. THE HISTORY OF THE TREATY SUGGESTS A NARROW READING OF ARTICLE XIV

Given the plain words of Article XIV, there is scant excuse to look further. Yet, since petitioner relies entirely on external evidence, we follow him in that quest, deferring to the rule that treaties are "to be read in the light of the conditions and circumstances existing at the time they were entered into, with a view to effecting the objects and purposes of the States thereby contracting." *Rocca* v. *Thompson*, 223 U.S. 317, 331–332. See also, *Choctaw Nation* v. *United States*, 318 U.S. 423, 431; *Factor* v. *Laubenheimer*, 290 U.S. 276, 294–295; *Cook* v. *United States*, 288 U.S. 102, 112; *Nielsen* v. *Johnson*, 279 U.S. 47, 52.[12]

The fact is, however, that the history of the Convention[13] and the context in which it was adopted

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[12] A comprehensive survey of the decisions of this Court dealing with the interpretation of treaties is given in 2 Hyde, *International Law Chiefly as Interpreted and Applied by the United States* (2d ed.), pp. 1478–1485; see also, Lauterpacht, *Restrictive Interpretation and the Principle of Effectiveness in the Interpretation of Treaties*, XXVI British Year Book of International Law (1949), pp. 48, 53, 67; American Law Institute, *Restatement of the Foreign Relations Law of the United States* (Proposed Official Draft, 1962), c. 4, pp. 536, *et seq.*; Harvard Research in International Law: Law of Treaties, Supplement to 29 Amer. Journal of Int. Law., pp. 937, *et seq.*; McNair, *The Law of Treaties* (1961), pp. 364, *et seq.*; Lidstone, *Liberal Construction of Tax Treaties*, 47 Cornell L.Q. 529, 544–546.

[13] Most of the documents bearing upon the legislative histories of our double taxation treaties have been compiled by the Staff of the Joint Committee on Internal Revenue Taxation, U.S. Congress, in a four volume set entitled "Legislative History of United States Tax Conventions." That compilation is cited in this brief as "Leg. Hist." An additional volume entitled "A Topical Comparison of United States Income Tax Conventions"

merely confirm our reading of Article XIV. Far from justifying a broad construction, the external evidence shows an extreme reluctance to continue the prevailing exemption for the capital gains of nonresident aliens. There is certainly no indication that the Convention was intended to affect the taxability of an American trust on its own retained capital gains.

The United Kingdom Convention was adopted against a background of controversy over the taxation of nonresident aliens. Since the Revenue Act of 1936, 49 Stat. 1648, their capital gains had been exempted if they were "not engaged in trade or business within the United States." Sec. 211, 1939 Code, as amended by the Revenue Act of 1942, 56 Stat. 798, § 160.[14] By 1945, there was a growing feeling

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has also been prepared by the Staff. A comparison of the various treaty provisions relating to exemption of capital gains will be found at pages 8a through 8e, Row 1, of the latter volume.

The history of the British treaty is set forth in detail at 2 Leg. Hist. 2566–2567. Briefly, the treaty was signed at Washington on April 16, 1945, and was transmitted to the Senate by the President on April 24, 1945. The Committee on Foreign Relations held hearings in May and June, 1945, and submitted its report on July 3, 1945. The Senate recommitted the treaty to the Committee on February 6, 1946, and further hearings were held in April, 1946. The treaty was again reported to the Senate on May 10, 1946, and the Senate gave its advice and consent on June 1, 1946. It was proclaimed by the President on July 30, 1946, and entered into force as of July 25, 1946, the date of exchange of instruments of ratification. See also, 1 Leg. Hist., table facing p. 6.

[14] The explanation given for exemption of capital gains of nonresident aliens was that it had "been found administratively impossible effectually to collect this latter tax." S. Rep. No. 2156, 74th Cong., 2d Sess., p. 21 (1936) (1939–1 Cum. Bull.

that the exemption was too broad. In 1950, the tax law was amended to subject nonresident aliens *temporarily* in the country to capital gains tax. Revenue Act of 1950, 64 Stat. 906, § 213. Accordingly, it is not surprising that the Convention, submitted in a period of transition toward a stiffer law, met serious opposition insofar as it proposed to exempt from the capital gains tax all British citizens and residents who had no "*permanent* establishment" in the United States. Art. II(2), qualifying Art. XIV. See also, Art. II(1)(l), defining "permanent establishment."

A substantial part of the hearings on the Convention was devoted to consideration of the effect which Article XIV might have upon existing law relating to the taxation of capital gains of nonresident aliens.[15] Concern with this problem was emphasized by the Senate Committee on Foreign Relations. Its Report of July 3, 1945, recites (S. Exec. Rep. No. 6, 79th Cong., 1st Sess., p. 2, 2 Leg. Hist. 2652):

(Part 2) 678, 691–692); H. Rep. No. 2475, 74th Cong., 2d Sess., p. 9 (1936) (1939–1 Cum. Bull. (Part 2) 667, 673). See also H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 30–31 (1937) (1939–1 Cum. Bull. (Part 2) 704, 725–726); S. Rep. No. 1242, 75th Cong., 1st Sess., pp. 32–33 (1937) (1939–1 Cum. Bull. (Part 2) 703, 725–726). The Revenue Act of 1942, c. 619, 56 Stat. 798, Section 160, eliminated the words "or having an office or place of business within the United States" as a factor in the taxing of nonresident aliens.

[15] 1 Hearing Before a Subcommittee of the Committee on Foreign Relations, on Conventions With Great Britain and Northern Ireland Respecting Income and Estate Taxes, S. Execs. D and E, 79th Cong., 1st Sess., pp. 25–27 (memorandum), p. 45 (Brief of National Foreign Trade Council), pp. 53–54 (Code), pp. 61–62 (King), pp. 66–68 (Carroll), pp. 73–75, 76, 79 (Stam); 2 Leg. Hist. 2591–2593, 2611, 2619–2620, 2627–2628, 2632–2634, 2639–2641, 2642, 2645.

Incident to your subcommittee's consideration of the proposed convention, four certain questions have attracted its special attention, namely:

* * * * *

(2) The relation of the provisions of the convention to our domestic principles of taxation of capital gains (primarily stocks, securities, and commodities) as applied to the alien resident in the United States and the nonresident alien who is engaged in trade or business in the United States;

Although the Committee reported it favorably on July 3, 1945 (Report, *supra,* p. 1, 2 Leg. Hist. 2651), action on the Convention was delayed (91 Cong. Record, p. 7448, 2 Leg. Hist. 2669) and, on February 6, 1946, it was recommitted to the Committee on Foreign Relations for further hearing (92 Cong. Record, pp. 946–947, 2 Leg. Hist. 2673). One of the reasons for the recommittal, as shown by the later Hearings [16] and by the second Report of the Senate Committee on Foreign Relations,[17] was continued concern over the possible effects of Article XIV.

The British convention was ultimately ratified, but it was the last of the agreements to confer an effective capital gains exemption on nonresident aliens. Similar provisions originally included in the Conventions

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[16] 2 Hearing Before a Subcommittee of the Committee on Foreign Relations, on Conventions with Great Britain and Northern Ireland Respecting Income and Estate Taxes, S. Execs. D and E., 79th Cong., 2d Sess. (Part 2), pp. 116–120 (King), 2 Leg. Hist. 2712–2716.

[17] S. Exec. Rep. No. 4, 79th Cong., 2d Sess., pp. 1, 2, 3–8; 2 Leg. Hist. 2721, 2722, 2723–2728.

signed with Denmark (62 Stat. 1730; 1 Leg. Hist. 711, 717—Art. XII) and the Netherlands (62 Stat. 1757; 2 Leg. Hist. 1921, 1927—Art. XI), were unfavorably reported,[18] and the treaties were ratified subject to reservations rejecting the offensive Articles.[19] The Convention with Ireland, transmitted to the Senate in 1950 [20] met the same fate,[21] despite an appeal to the

[18] The report on the Danish treaty stated (S. Exec. Rep. No. 10, 80th Cong., 2d Sess., p. 2. 1 Leg. Hist. 698):

"The committee, however, in its consideration of the convention, has been aware of the pendency in Congress of the question of amending existing provisions of the Internal Revenue Code relating to the taxation of capital gains derived by nonresident aliens or by foreign corporations from sources within the United States, and of the effect thereon of provisions of existing tax conventions containing articles relating to capital gains. The proposed convention, in article XII, would exempt from United States income tax the capital gains of nonresident aliens who are residents of Denmark and Danish corporations, if such alien or corporation is not engaged in trade or business within the United States.

"The committee feels that it is untimely to freeze by tax conventions the provisions of existing law in that respect pending further legislative consideration of the question."

The report on the Netherlands treaty was to the same effect. S. Exec. Rep. No. 11, 80th Cong., 2d Sess., p. 2, 2 Leg. Hist. 1908.

[19] Denmark—94 Cong. Record, p. 8622, 1 Leg. Hist. 703–704; Netherlands—94 Cong. Record, p. 8625, 2 Leg. Hist. 1914.

[20] Message from the President, S. Exec. F, 81st Cong., 2d Sess., p. 1, 2 Leg. Hist. 1584A.

[21] S. Exec. Rep. No. 1, 82d Cong., 1st Sess., pp. 19–20, 1 Leg. Hist. 603–604. The report said, in part (p. 20, 1 Leg. Hist. 604):

"Because of the strong objections which have been raised previously in the Congress to the exemption of nonresident aliens from tax on their capital gains from transactions entered into in the United States, the committee recommends that article XIV of the convention with Ireland relating to income taxes be eliminated and proposes a reservation to that effect."

"intimate relation" between the tax laws of Ireland and Great Britain.[22]

The hostile climate strongly suggests that Article XIV of the British Convention would never have won ratification had it been understood as conferring the indirect exemption urged here. Indeed, the provision was accepted, albeit reluctantly, on assurances[23] that it

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[22] Message from the President, *supra*, fn. , pp. 3, 5; 2 Leg. Hist. 1584–C, 1584–E.

[23] Message from the President, S. Exec. D, 79th Cong., 1st Sess., p. 1, 2 Leg. Hist. 2573. The President's Message was accompanied by a report of the Secretary of State advising that "In matters of principle and substance, most of the provisions of the convention relating to taxes on income are consistent, if not identical, with provisions in one or another of the existing income-tax conventions between the United States of America and certain foreign countries, namely," Sweden, Canada and France. S. Exec. D, *supra*, p. 2, 2 Leg. Hist. 2574. A more detailed explanation of the significant provisions of the Convention was then given, "particularly with a view to indicating the extent to which the convention may modify the existing revenue laws of the United States." *Id.*, p. 4, p. 2576. No mention was there made of Article XIV as one which "may modify the existing revenue laws." As the subsequent history shows, the Senate was in no mood to extend exemption of capital gains further than had been done in the previous conventions.

The Report of the Senate Committee on Foreign Relations (S. Exec. Rep. No. 6, 79th Cong., 1st Sess., p. 4, 2 Leg. Hist. 2654), indicates that those assurances were credited:

"* * * As above indicated, there may be certain cases falling in between the test of being engaged in trade or business and having a permanent establishment where the convention is more liberal than existing law, but there are other compensating factors and *no such technical conflict exists where the test of taxation is residence. Moreover, the same provisions found in the British convention are now in effect under the conventions with Canada, Sweden, and France.*" (Emphasis added.)

See also the references to Article XIV in the Technical Memorandum of the Treasury Department on the Convention; S. Exec. Rep. No. 6, *supra*, pp. 5, 6, 12; 2 Leg. Hist. 2655, 2656, 2662.

accorded British citizens and residents no greater relief with respect to capital gains than had already been accorded nonresident aliens in the recent tax treaties with Sweden, France and Canada.[24] And the Regulations promulgated under those Conventions expressly affirmed the continued taxability of undistributed trust gains, unaffected by the exemption granted the beneficiaries as nonresident aliens with respect to their own capital gains.[25]

Against this background, petitioner's arguments are not persuasive. Certainly nothing can be read into the absence of an explicit "savings clause." For, while the Swedish, French and Canadian Conventions contain such a clause,[26] we have just seen that the British treaty meant to go no further in exempting capital gains. The answer is, of course, that Article II(1)

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[24] The respective dates are (Tables at 1 Leg. Hist. 6):

Country	*Signed*	*Proclaimed by President*	*Capital Gains Article*
Sweden	3/23/39	12/12/39	IX
France	7/25/39	1/ 5/45	11
Canada	3/ 4/42	6/17/42	VIII
United Kingdom	4/16/45	7/30/46	XIV

The delay in the adoption of the French treaty was caused by World War II. S. Exec. Rep. No. 4, 78th Cong., 2d Sess., p. 1, 1 Leg. Hist. 881.

[25] The relevant sections of the Regulations are: Canada, Section 519.11, 26 C.F.R. 519.11; France, Section 514.7, 26 C.F.R. 514.7. The Swedish Regulations, which were the first in the series to be issued, do not contain a corresponding provision. See, however, Section 520.102 of the Swedish Regulations, 26 C.F.R. 520.102.

[26] Sweden, Art. XIV(a), 2 Leg. Hist. 2365; France, Art. 14A, 1 Leg. Hist. 915–916; Canada, Art. XVII, 1 Leg. Hist. 481. See Staff of the Joint Committee on Internal Revenue Taxation, U.S. Congress, A Topical Comparison of United States Income Tax Conventions, pp. 2a–2e, Row 4.

(g) of the United Kingdom Convention, which excludes from the scope of Article XIV American citizens, American corporations, and all persons deemed "resident in the United States for the purposes of United States tax," accomplishes the same end. Rev. Rul. 59-56, 1959-1 Cum. Bull. 737, 738, 741. See also, S. Exec. Rep. No. 6, 79th Cong., 1st Sess., pp. 4, 12, 2 Leg. Hist. 2654, 2662; Sen. Exec. Rep. No. 4, 79th Cong., 2d Sess., pp. 11, 19, 2 Leg. Hist. 2731, 2739.

Nor is there substance to petitioner's "reciprocity" and "equality" arguments. The plain fact is that the treaty was never intended to achieve full equality of treatment between citizens and residents of the two governments. One object of Article XIV was to eliminate a possible area of double taxation, with respect to those capital gains which the British then,[27] or later,[28] might tax. But, to a larger extent perhaps, the provision was simply a concession made by the American government in return for other concessions made by the British, particularly in the area of fiscal information. See Message from the President, S.

[27] For illustrations of taxable capital gains under the former British law, see Brudno and Hollman, The Taxation of Capital Gains in the United States and the United Kingdom, 1958 British Tax Rev. 26, 134. That the present transactions would not have been taxed in the United Kingdom hardly proves that the Article, which applies to *all* capital gains, was not addressed to the problem of double taxation.

[28] The fact is that British law as to the taxation of capital gains was in a state of flux. See the 1958 Final Report of the Royal Commission on the Taxation of Profits and Income, Cmd. 9474, pp. 25 *et seq.*, 365 *et seq.*, 425 *et seq.* This culminated in adoption of provisions in 1962 expressly taxing capital gains. Finance Act, 1962, c. II, Secs. 10-16, 10 and 11 Eliz. 2, c. 44, Law Reports, Statutes, 1962, part 3, pp. 695, 707 *et seq.*

Exec. D., 79th Cong., 1st Sess., p. 5, 2 Leg. Hist. 2577.[29] Only in this sense is Article XIV "reciprocal."[30]

In sum, there is in all the history of the negotiation and ratification of the British Convention not the slightest hint that it was intended to reach further than the text itself suggests. On the contrary, the external evidence confirms the expressed purpose of the treaty to exclude from its scope all "persons" whom either sovereign viewed as a taxable resident. Plainly, the Convention was addressed to *inter*-national problems; it was not meant to disturb the structure of American tax law as it affects American income of resident American taxpayers. The true goal of the Convention, as the Proclamation which precedes it announces (Pet. App. A1), was "the avoidance of double taxation and the prevention of fiscal evasion," problems altogether foreign to this case. The conclusion must be that the present trust is beyond the treaty's jurisdiction.

C. THE TREASURY REGULATIONS PROMULGATED UNDER THE CONVENTION REJECT PETITIONER'S CLAIM OF EXEMPTION

Immediately after the treaty was ratified, both countries promulgated regulations to carry it into ef-

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[29] See also, the testimony of Special Deputy Commissioner King relating the American concession in Article XIV directly to the British concession in Article XX. 1 Hearing on Conventions, etc., *supra*, Execs. D and E, 79th Cong., 1st Sess., pp. 56–58, 60, 61–62; 2 Leg. Hist. 2622–2624, 2626, 2627–2628.

[30] Our willingness to agree to Article XIV is partly attributable to the difficulties of collecting the tax due by nonresident aliens. See 1 Hearing, *supra*, p. 26, 2 Leg. Hist. 2592. Needless to say, the same problems are not encountered in connection with a domestic trust.

fect.[31] The American regulations, which of course govern as to taxes imposed by the United States, confirm our reading of Article XIV.

Thus, Section 507.103(b) of the Treasury Regulations (App., *infra*, p. 29) interprets the treaty as exempting capital gains resulting from sales or exchanges "*by*" a British resident—not gains realized by someone else[32] *for the eventual benefit* of a British resident. See also, Section 507.112 (App., *infra*, pp.

[31] Our Treasury Regulations were issued originally as T.D. 5532, 1946–2 Cum. Bull. 73 (withholding regulations), and T.D. 5569, 1947–2 Cum. Bull. 100 (general regulations). They appear as Title 26, Part 507, Code of Federal Regulations, p. 106 *et seq.* The British Double Taxation Relief (Taxes on Income) (U.S.A.) Regulations, 1946, appear at Vol. X Statutory Rules and Orders and Statutory Instruments, Revised to December 31, 1948, pp. 332–333; see also Double Taxation Relief (Taxes on Income) (General) Regulations, 1946, *id.*, pp. 328–331. In addition, the British issued several relevant "circulars". Ehrenzweig and Koch, *Income Tax Treaties*, pp. 288–296.

[32] Section 507.104 of the Regulations, defining "resident of the United Kingdom," states that it includes a "fiduciary." Therefore, a United Kingdom trust deriving capital gains from United States sources, and not distributing them to the beneficiaries, would be exempt from tax thereon under Article XIV even though the beneficiaries were residents of the United States. See fn. 10, *supra*. If the petitioner's position in this case were adopted, the result would be that capital gains of a British trust with American beneficiaries would be deprived of the exemption. This illustrates, as is frequently the case when a tax provision is sought to be given a "liberal" interpretation, that what is liberal as to one party may be illiberal as to others. Cf. *Helvering* v. *Hutchings*, 312 U.S. 393, 397.

30–31).[33] Any remaining doubt is dispelled by Section 507.108(*e*) of the Regulations (App., *infra*, p. 30):

> (e) ***Beneficiaries of an estate or trust.*** (1) A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption * * * provided in Articles * * * XIV of the convention with respect to * * * capital gains ***to the extent such items or items are included in his distributive share of income*** of such estate or trust if he * * * is not engaged in trade or business in the United States through a permanent establishment. * * * [Emphasis added.][34]

Embodying as they do the contemporaneous construction of those charged with the administration of the treaty, the Treasury Regulations are of course entitled to great weight. *Kolovrat* v. *Oregon*, 366 U.S. 187, 194; *Pigeon River Co.* v. *Cox Co.*, 291 U.S. 138, 160–161; *Factor* v. *Laubenheimer*, 290 U.S. 276, 294–295; *Nielsen* v. *Johnson*, 279 U.S. 47, 52; American Law Institute, *Restatement of the Foreign Relations Law of the United States* (Proposed Official Draft 1962), Sec. 155, p. 558 *et seq.*[35] But, here,

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[33] Petitioner recognizes the obvious implications of the word "by" (Pet. Br. 41).

[34] We have omitted from this quotation language which is relevant to the other exemptions or reductions in tax generally covered by the provision. We agree with the petitioner (Br. 40) that the words "if he is taxable in the United Kingdom on such income" do not apply to the capital gains exemption of Article XIV. See also, Section 507.10 (App., *infra*, p. 28).

[35] Petitioner's suggestion (Br. 42) that the Regulations should be viewed with "skepticism" because they were issued without authority under the treaty is refuted by the practical action of the parties. Furthermore, Section 62 of the 1939 Code, under which they were issued, is sufficient authority. See Regulations, Section 507.102.

there are additional reasons for according them special significance.

Every indication is that the Regulations just cited were approved by the British Government before promulgation. Indeed, during the course of the hearings on the proposed double taxation treaty with France (S. Exec. A., 80th Cong., 1st Sess.), Special Deputy Commissioner Eldon P. King testified (p. 24, 1 Leg. Hist. 962):

> Now we come to the regulation. It depends somewhat on the nature of it and the importance of it. *If it is something we think the other country should see, we show them the regulation.* We did that with Canada, *we did it with England. We had joint meetings and went over the regulations together, and all agreed.* They do the same with us. If they are getting ready to is[s]ue something they think we will have an interest in, they send it to us, *so you might say it is joint*, except in the case of a pro forma matter that the other country could not possibly have an interest in. [Emphasis added.]

That there was advance agreement is apparent, also, from a comparison of the American and British regulations, issued almost simultaneously. Their consistency is not accidental.

In any event, the fact is that the Regulations have survived to this day without objection. In connection with the Second Supplementary Protocol of May 25, 1954 (6 U.S.T. 37; 2 Leg. Hist. 2819), Which extended the application of the treaty to certain British territories, the United Kingdom had ample opportu-

nity to voice dissatisfaction with our interpretation. See also Agreement between the United States and the United Kingdom (9 U.S.T. 1459; 2 Leg. Hist. 2951). Likewise, our Own Congress has not lacked occasion to require changes in the Regulations. Yet, no complaints have been heard; no change has been suggested. The reason must be that the Regulations correctly interpret the treaty.

CONCLUSION

For the reasons stated, the decision of the court of appeals should be affirmed.

Respectfully submitted,

ARCHIBALD COX,
Solicitor General.
LOUIS F. CLAIBORNE,
Assistant to the Solicitor General.
LOUIS F. OBERDORFER,
Assistant Attorney General.
MEYER ROTHWACKS,
HAROLD C. WILKENFELD,
Attorneys.

MARCH, 1963.

APPENDIX

Treasury Regulations on Tax Convention with United Kingdom (26 Code of Federal Regulations):

Part 507—United Kingdom

SUBPART—WITHHOLDING OF TAX

* * * * *

Sec. 507.10 ***Beneficiaries of a domestic estate or trust.***

A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, provided in Articles VI, VII, VIII, and IX of the convention with respect to dividends, interest, royalties, natural resource royalties, and rentals from real property to the extent such item or items are included in his distributive share of income of such estate or trust. In such case such beneficiary must, in order to be entitled to the exemption or reduction in the rate of tax, execute Form 1001A–UK and file such form with the fiduciary of such estate or trust in the United States.

* * * * *

SUBPART—GENERAL INCOME TAX

* * * * *

Sec. 507.103. ***Scope of the convention.***

(a) The primary purposes of the convention, to be accomplished on a reciprocal basis, are to avoid double taxation upon major items of income derived from sources in one country by persons resident in the other country, and to

exchange fiscal information complementary to other provisions of the convention, including those relating to avoidance of double taxation.

(b) The specific classes of income from sources within the United States exempt under the convention from United States tax for taxable years beginning on or after January 1, 1945, are:

* * * * *

(7) Gains from the sale or exchange of capital assets by a nonresident alien who is a resident of the United Kingdom or by a foreign corporation managed and controlled in the United Kingdom, if such alien or corporation has no permanent establishment in the United States (Article XIV);

* * * * *

(e) The convention does not affect the liability to United States income taxation of subjects of the United Kingdom who are residents of the United States except that such individuals are entitled to the benefits of Article X (relating to United Kingdom Government salaries and the like), of Article XIII(1) (relating to credit for United Kingdom income tax), and of Article XXI (relating to equality of taxation). Except as provided in Article X with respect to a citizen of the United States who is also a British subject and in Article XIII relating to the credit for income tax, the convention does not affect taxation by the United States of a citizen of the United States or of a domestic corporation, even though such citizen is resident in the United Kingdom and such corporation is managed and controlled in the United Kingdom. * * *

* * * * *

Sec. 507.108. *Exemption from, or reduction in rate of, United States tax in the case of dividends, interest, royalties, natural resource royalties, and real property rentals.*

* * * * *

(c) *Beneficiaries of an estate or trust.* (1) A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption * * * provided in Articles * * * XIV of the convention with respect to * * * capital gains to the extent such item or items are included in his distributive share of income of such estate or trust if he * * * is not engaged in trade or business in the United States through a permanent establishment. In such case such beneficiary must, in order to be entitled to the exemption or reduction in the rate of tax, execute Form 1001–UK or Form 1001A–UK (modified to show dividends where applicable) and file such form with the fiduciary of such estate or trust in the United States.

(2) In any case in which dividends, interest, royalties, rents or the like are derived from United States sources by a United Kingdom estate or trust any beneficiary of such estate or trust who is not a resident of the United Kingdom is not entitled to any exemption under the convention with respect to such income included in his distributive share of the income of the estate or trust.

* * * * *

Sec. 507.112 *Capital Gains.*

Under Article XIV of the convention, when read in association with Article II(2) of the convention, gains from the sale or exchange of capital assets by a nonresident alien individual who is a resident of the United Kingdom or by a foreign corporation managed and controlled in the United Kingdom are, for taxable years beginning on or after January 1, 1945, exempt from Federal income tax unless such alien or corporation has a permanent establishment in the United States. As to what constitutes capital assets, see section 117, Internal Revenue Code. As to what constitutes a perma-

nent establishment see § 507.104. If A, a non-resident alien individual who is a resident of the United Kingdom, performs personal services within the United States during the calendar year 1946 for a domestic employer, he is engaged in trade or business within the United States in such taxable year. Section 211(b), Internal Revenue Code. He carries on in that year no other business activity within the United States other than certain securities transactions upon a domestic stock exchange and maintained no office or other fixed place of business within the United Sates at any time during such year. A is not subject to Federal income tax upon his capital gains, if any, realized from his securities transactions. Likewise, a foreign corporation managed and controlled in the United Kingdom selling its products manufactured in the United Kingdom through a resident commission agent or broker in the United States and having certain securities transactions within the United States as its only other business activity therein is exempt from United States tax upon those capital gains, if any, arising from the securities transactions within the United States.

U. S. GOVERNMENT PRINTING OFFICE 1945

IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 240.

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER.

D. NELSON ADAMS,
DAVID A. LINDSAY,
JOHN A. REED,
JOHN A. CORRY,
Attorneys for Petitioner.
1 Chase Manhattan Plaza,
New York 5, New York

Of Counsel:
DAVIS POLK WARDWELL SUNDERLAND & KIENDL.
HILL BETTS YAMAOKA FREEHILL & LONGCOPE.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962.

No. 240.

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

REPLY BRIEF FOR PETITIONER.

Respondent's Point A.

Respondent does not question petitioner's position that the British beneficiaries suffered the economic burden of the tax.[1]

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[1] Even so, he refers to the children of the grantor in our case as "contingent remaindermen" (Res. Br. p. 3) and in footnotes 1 and 2 (Res. Br. pp. 2-3) he lists contingencies as to the wife and the children, without noting that the principal contingencies, such as termination by the grantor, or the discretionary payment of principal by the trustee, would merely shift the interest in the corpus (and the retained capital gains) among a class of British beneficiaries (including the grantor) all of whom are residents of the United Kingdom. There may be a contingency as to an individual member of a family but not as to the family as a whole.

Under the Government's position, the capital gains would be taxable to the petitioner even though the trust instrument *expressly* required that the future distributions be made *only* to persons then resident in the United Kingdom.

Respondent rests his case on the premise that the term "exempt" as used in Article XIV of the Treaty means exempt only from the duty of paying the tax to the Treasury and that such term cannot mean exempt from the economic burden of the tax. In so doing he does not undertake to analyze the Treaty as a whole and altogether ignores the British effort to achieve reciprocity in terms of the economic burden of the tax. (Pet. Br. pp. 19-25.)

Respondent attempts to read domestic law into the Treaty but, under Sections 894 (26 U. S. C. §894) and 7852 (26 U. S. C. §7852) of the Internal Revenue Code of 1954, we are required to read the treaty exemption into our domestic law. (Pet. Br. pp. 36-37.) In support of his position, respondent states that under our domestic law a "trust is a separate taxable entity" (Res. Br. p. 7), "the English beneficiaries * * * are not the taxpayer" (Res. Br. p. 4) and concludes that petitioner's position "is at war with the American tax system" (Res. Br. p. 4) and "would contradict the whole scheme of trust taxation in the United States". (Res. Br. p. 10.)

Three cases are cited in the text of respondent's brief[2] in support of this charge (pp. 11-13). Two, *Biddle* v. *Commissioner*, 302 U. S. 573 (1938) and *Klein* v. *Board of Tax Supervisors*, 282 U. S. 19 (1930) (Res. Br. p. 11), involved *corporations*, not *trusts*. (Pet. Br. p. 24.) Their inapplicability to the taxation of trusts, even under domestic law, is shown by the fact that while in *Biddle* an Ameri-

[2] The only other cited cases are found in footnote 8 (Res. Br. pp. 11-12) dealing with (a) "intergovernmental immunity" cases having to do with controversial imposition of excise taxes on "cost-plus" government contractors, and income taxation of the salaries of state or federal employees, and (b) authorities relating to, in respondent's own words, "[T]heoretical economic distinctions between 'direct' and 'indirect' taxes [which] are irrelevant in the present context".

can recipient of a dividend from a British corporation was denied a credit on account of foreign income taxes paid by the corporation, an American beneficiary of a foreign trust has from the outset been allowed a credit for foreign income taxes paid by the trust.[3]

The respondent's emphasis on the *Biddle* case is particularly inapposite since the British secured its reversal in Article XIII of the Treaty. (Pet. Br. p. 24.) This assurance of reciprocity in terms of economic burden of tax in the field of corporate-stockholder relations shows the extent to which the United States acceded to the British concept in order to secure equally substantial concessions by the United Kingdom in the areas of exchange of information and foreign tax credits.

The third and last case cited in the text of respondent's brief that purports to deal with the "scheme of trust taxation in the United States" is totally irrelevant to the issue now before the Court. *Anderson* v. *Wilson*, 289 U. S. 20 (1933). (Res. Br. p. 13.)[4]

In *Anderson* v. *Wilson* this Court observed that in order to "determine whether the loss was one suffered by the trust estate, or one suffered by the taxpayer to whom the proceeds of the sale were payable, there is need at the out-

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[3] See Section 901(b)(4) of the Internal Revenue Code of 1954, 26 U. S. C. §901(b)(4), first enacted as Section 222(a)(4) of the Revenue Act of 1918, 40 Stat. 1073. See also Section 642(a)(1) of the Internal Revenue Code of 1954, 26 U. S. C. §642(a)(1).

[4] Respondent quotes dictum from *Anderson* v. *Wilson* at page 13 of his brief, but the selected quotation contains an interesting omission. The omitted portion of the quotation, represented by asterisks in respondent's brief, reads as follows (at pp. 26-27):

> "Whether the result would be the same if the beneficiaries had been the owner of future estates in remainder, we are not required to determine. Cf. *Francis* v. *Commissioner*, 15 B. T. A. 1332, 1340. Our ruling will be kept within the limits of the case before us."

set to determine the meaning of the will". (289 U. S. 20, 24.) In the words of this Court (289 U. S. 20, 26):

> "Our answer to the inquiry as to the meaning of the will comes close to being an answer to the inquiry as to the incidence of the loss. The taxpayer has received the only legacy bequeathed to him, and received it as it was given without the abatement of a dollar. What was bequeathed was an interest in a fund to be made up when the trustees were of opinion that it would be advisable to sell. This alone was given, and this has been received."

Even assuming that the treaty exemption must be construed in light of domestic law, respondent cites no authority for his position that the exemption granted United Kingdom beneficiaries must be defeated because the domestic trust and not the English beneficiaries is "the taxpayer".

Respondent's observation that Article XIV of the Treaty "exempts *persons*, not income as such" (Res. Br. p. 7) is not relevant where the "person" is the equitable owner of the income and the trust is the "taxpayer".[5] In *Lederer* v. *Stockton*, 260 U. S. 3 (1922) the exemption of a hospital was not defeated by the interposition of a domestic

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[5] Nor is petitioner's "concession" (Res. Br. pp. 5-6) that, absent Article XIV, the trust "would owe the contested tax notwithstanding that the beneficiaries are all nonresident aliens" really pertinent. Apart from the Treaty, there is no express "exemption" for nonresident aliens with respect to capital gains. Capital gains are not subject to the withholding tax provisions generally applicable to nonresident aliens because capital gains are not considered the type of income ("fixed or determinable, annual or periodical") that is subject to withholding. (See note 9, *infra*, p. 10.)

To say, as does respondent (Res. Br. p. 8), that Article XIV seems "to deal with a British resident only with respect to *his* own income and to *his* own tax liability" begs the question. The United Kingdom negotiators were primarily concerned with the burden of United States taxation and it is the beneficiaries of the trust whose interests are depleted by our capital gains tax.

trust. (Pet. Br. p. 34.) *Lederer* v. *Stockton* arose prior to the statutory allowance of a deduction in respect of income of a trust or estate "permanently set aside" for a charity (Pet. Br. p. 34), and has been cited for the proposition that "income of an estate or trust accumulated during the taxable year is deductible although it has not actually been given to a charitable organization or used directly for a charitable purpose". *Arthur Jordan Foundation* v. *Commissioner*, 210 F. 2d 885, 888 (7th Cir. 1954).

In commenting on *Lederer* v. *Stockton* in another case, Judge Augustus Hand observed that while the trustee in the *Stockton* case made "a loan of the corpus of the trust to the tax exempt remainderman," and that while this Court based its decision on the ground that the charitable organization in effect enjoyed the use of the income, the Circuit Court of Appeals below had also relied on the further ground that the remainderman "was the beneficial owner of the income." *Slocum* v. *Bowers*, 15 F. 2d 400, 403 (S. D. N. Y. 1926), *aff'd*, 20 F. 2d 350 (2d Cir. 1927).[6] Judge Hand went on to say (*ibid.*):

> "But the Supreme Court in no way disapproved of the additional ground adopted by the Court of Appeals and Chief Justice Taft, who wrote the opinion, reported in 260 U. S. 3, 43 S. Ct. 5, 67 L. Ed. 99, said: 'This residuary fund was vested in the hospital. The death of the annuitant would completely end the trust'." (At p. 403.)

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[6] In *Slocum* v. *Bowers* Judge Augustus Hand held that undistributed income of an estate (estates and trusts are governed by the same rules) was exempt because the income was "ultimately" passed to charitable legatees, stating it is hard to believe that in the one case of administration of an estate the exemption "should turn on the technical question of whether the corporations seeking it have the legal or equitable title to the income." 15 F. 2d 400, 403. The Circuit Court of Appeals for the Second Circuit affirmed, but on other grounds, relying solely on the statutory provision, first enacted in 1918 (40 Stat. 1071) permitting a deduction for income "permanently set aside" for a charity. 20 F. 2d 350.

Fundamentally, the fact that to a limited extent a trust is "the taxpayer" under domestic law is grounded upon considerations of tax policy which are entirely different from those which form the basis of Article XIV. Our domestic laws insure that taxable income held in trust is taxed only once, either to the trust or to the beneficiary, and the liability to pay the tax equitably falls upon whichever "taxpayer" has possession of the income and hence the ability to pay the tax. The trust is not a separate taxable entity in the sense of a corporation which permits the imposition of tax twice on the same income, first in the hands of the corporation, and second in the hands of the stockholder when distributed as a dividend.

It is inconceivable that the British negotiators intended to cast an exemption accorded their residents into an ever changing morass of administrative interpretation relating to domestic law. Respondent's statement that the treaty exemption "does not purport to override our revenue laws" (Res. Br. p. 14) is particularly unpersuasive in light of his reliance on Rev. Rul. 62-154 (Res. Br. p. 8) relating to the "test for determining the residence of a trust".[7]

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[7] As early as 1923 in I. T. 1885, II-2 Cum. Bull. 164 (1923), it was stated that the residence of a trust has nothing to do with the citizenship or residence of the trustee. On the other hand, in *B. W. Jones Trust* v. *Commissioner*, 132 F. 2d 914 (4th Cir. 1943) the Commissioner successfully contended that the residence in the United States of one of four trustees, who had possession of most of the trust assets, was itself sufficient to render the trust, established by a British subject for British beneficiaries, taxable as a United States resident. Confusion on this subject persists, as shown in Rev. Rul. 62-154.

The Court will be able to gauge the extent of "morass" in this area, from the following language in Rev. Rul. 62-154, Int. Rev. Bull. 1962-38, at 8:

> "The question was asked because I. T. 1885, C. B. II-2, 164 (1923), which was referred to in Revenue Ruling 57-245 in support of the Service position, was modified by Revenue Ruling 60-181, C. B. 1960-1, 257, and because the result

Nevertheless, respondent finds "reference" to our domestic law "permissible" under Article II(3) of the Treaty. (Res. Br. p. 14.) Article II(3) deals with the definition of terms and not with substantive provisions of the Treaty. In view of the incorporation of the treaty exemption in Section 894 of the Internal Revenue Code and the express deference in Article II(3) to the "context" of the Treaty it is inappropriate to construe the treaty exemption in terms of the technical concept of a trust as the "taxpayer". In following the British lead and placing the laws on a reciprocal basis within the Treaty (Pet. Br. p. 21), the parties fashioned substantive provisions which focus on tax burdens and disregard the legal incidence of the tax and the technical identity of the *pro forma* taxpayer. (Pet. Br. pp. 19-25.) Article XIV has the sole function and purpose of accomplishing reciprocity of tax treatment, and if reciprocity is to be accorded to capital gains, the word "exempt" must embrace in its meaning the type of exemption which it is designed to reciprocate, namely, the same relief from tax in the United States as is accorded to capital gains in the United Kingdom. (Pet. Br. pp. 13-14.) This is the context in which Article XIV must be interpreted, and this is the context which stamps "exempt" with its meaning: release from the burden of taxation.

Respondent's Point B.

Respondent has virtually abandoned the treaty analysis on which the Court below based its decision and retreats to an altogether different line of defense.

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reached in Revenue Ruling 58-232 appears inconsistent with such modification of I. T. 1885."

Rev. Rul. 62-154 modified Rev. Rul. 57-245 and superseded Rev. Rul. 58-232.

Thus, respondent now relies on the "controversy over the taxation of nonresident aliens" (Res. Br. p. 16) and the "climate of growing hostility toward exemption for nonresident aliens". (Res. Br. p. 5.) However, respondent failed to reveal to this Court the nature of this "controversy" or the cause of the "hostility".

The hostility was directed exclusively at wealthy "refugees" who had been "making large sums of money trading on our stock exchanges", and who were physically present in the United States but were treated as nonresidents under the Internal Revenue Code and its administrative and judicial interpretation.

The fourth objection stated in the memorandum prepared by the Committee on Foreign Relations states:

> "Thus refugees who are not residents of the United States have been making large sums of money trading on our stock exchanges. The convention not only continues this existing practice but enlarges the exemption to apply to any British resident who does not have a permanent establishment in the United States." S. Exec. D, 79th Cong., 1st Sess. 25-26, 2 Legislative History of U. S. Tax Conventions (hereinafter cited as 2 Leg. Hist.) 2591-2592.

In part answer to this objection, again referring to "gains realized in the United States by a nonresident alien individual by reason of war conditions who has brought his capital into the United States and is actually living there for an indefinite period of time", the same memorandum states:

> "The tax situation presented by such aliens finds no parallel in the casual business visitor from the United Kingdom, who in the normal pursuit of his business or profession visits the United States for a short period of time. * * * Obviously, there are few,

if any, British refugees." S. Exec. D, 79th Cong., 1st Sess. 27, 2 Leg. Hist. 2593.

Testifying on the same subject, Mr. Stam pointed out that the matter was being investigated by the Internal Revenue Service (S. Exec. Rept. No. 6, 79th Cong., 1st Sess. 4, 2 Leg. Hist. 2654) and the Report of the Senate Finance Committee states:

> "* * * the subcommittee is aware of the fact that the Bureau of Internal Revenue has under active investigation the taxation of capital transactions of refugee aliens in the United States and the possibility of legislation, if found necessary, to supplement such program." S. Exec. Rept. No. 6, 79th Cong., 1st Sess. 4, 2 Leg. Hist. 2654.

Again the only respect in which the supplemental hearings considered the capital gains question was in connection with the taxation of war refugees, and a report on this subject prepared by Mr. Eldon King was submitted and is set forth in Hearings on the Income and Estate Tax Conventions Before a Subcommittee of the Committee on Foreign Relations of the United States Senate, 79th Cong., 1st Sess. 116-120, S. Exec. Rept. No. 4, 79th Cong., 2d Sess. 4-8, 2 Leg. Hist. 2712-2716, 2724-2728.

The "hostility" to the transient alien problem culminated in the enactment of Section 213 of the Revenue Act of 1950 (64 Stat. 906),* which taxed certain capital gains realized by nonresident aliens "temporarily present in the United States". The problem, nevertheless, was considered to have "no parallel in the casual business visitor from the United Kingdom" (S. Exec. D, 79th Cong., 1st

*Now Section 871(a) of the Internal Revenue Code of 1954, 26 U. S. C. §871(a).

Sess. 27, 2 Leg. Hist. 2593) and has no bearing whatsoever on the issue in this case.

In view of the "climate of hostility" with respect to refugees physically present in the United States and more especially in view of the language of the Treasury Regulations under Article XIV, it is clear that "assurances" to the effect that the British Treaty did not accord broader relief from capital gains tax than the earlier treaties were made in the context of nonresident aliens "temporarily present in the United States".

Respondent's leap to the conclusion that Article XIV in other respects "accorded British citizens and residents no greater relief" than was accorded by the earlier treaties (Res. Br. pp. 20-21) is demonstrably wrong. As shown in our opening brief (Pet. Br. pp. 18-19), the earlier treaties with Sweden (Art. IX, 54 Stat. 1764), France (Art. 11, 59 Stat. 899) and Canada (Art. VIII, 56 Stat. 1402) conferred an exemption only with respect to gains derived from the sale or exchange of capital assets "by" the qualifying foreign resident. Reflecting this difference in language, the Treasury Regulations under each of the treaties infer that the United Kingdom Treaty is the only treaty in which exemption from the United States capital gains tax applies where the property sold is sold "by" a domestic trust.[9]

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[9] Section 7.514 of T. D. 5569, 1947-2 Cum. Bull. 190, 26 C. F. R. §507.103, which purports to permit a trust beneficiary to claim exemption from tax *under the Treaty*, albeit apparently limited to distributable gains (Pet. Br. p. 39), has no counterpart in the prior treaties (Canada T. D. 5206, 1943 Cum. Bull. 526, 26 C. F. R. §519, France T. D. 5499, 1946-1 Cum. Bull 134, 26 C. F. R. §514, Sweden T. D. 4975, 1940-2 Cum. Bull. 43, 26 C. F. R. §520). Since capital gains are not subject to the withholding tax provisions generally applicable to nonresident aliens, not being "fixed or determinable, annual or periodical" income (See Section 871 of the Internal Revenue Code of 1954, 26 U. S. C. §871), the difference under the treaties has application only under §213 of the Revenue Act of 1950 (p. 9, *supra*) which subjects nonresident aliens

The sole issue raised in this case relates only to the *extent* of the exemption accorded by the Treaty, that is to say, whether it applies only to a beneficiary to whom gains are currently distributable.

The admitted application of Article XIV to distributable gains from the sale of property held in a domestic trust, in contrast to more restrictive rules under prior treaties, is necessarily based on the broad language in which Article XIV is cast. Since the only basis for exempting *any* gain in a domestic trust is the broad language of Article XIV, and not our domestic law, there is no possible basis for distinguishing between distributed and undistributed gains or between income beneficiaries and remaindermen.

It is patently in error to say (Res. Br. pp. 21-22) that Article II(1)(g) "accomplishes the explicit saving clause found in all prior treaties". As stated by the Tax Court, the saving clause provision in the Swedish Treaty assures that "each specific item of income is made subject to tax in one or the other of the two countries" and does "not exempt a class of income from taxation by both of the contracting states." *Lewenhaupt* v. *Commissioner*, 20 T. C. 151, 160 (1953), *aff'd per curiam*, 221 F. 2d 227 (9th Cir.

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temporarily present in the country to capital gains tax unless exempt by treaty.

In this connection, in Point C of his brief, respondent states (p. 24) that the Treasury Regulations interpret the Treaty "as exempting capital gains resulting from sales or exchanges '*by*' a British resident—not gains realized by someone else *for the eventual benefit* of a British resident" (emphasis respondent's). This language, while presumably appropriate only when applied in the case of property directly owned by a resident of the United Kingdom, reflects the distinctly different language of the three earlier treaties. Literally applied, respondent's argument here would mean that no gain from the sale of property sold "by" a domestic trust can be exempt under the Treaty, even though the gains are distributable within the taxable year of the sale. This contradicts the Government's position that the Treaty applies to distributable gains from the sale of property "by" a domestic trust.

1955). The Tax Court observed (at pp. 160-161) that Article XIV of the Swedish Convention (54 Stat. 1767), which contained both the tax credit provision and the saving clause, "was made the key provision by means of which most of the articles dealing with the avoidance of double taxation with respect to specific items of income were rendered possible." The Ninth Circuit in *American Trust Company* v. *Smyth*, 247 F. 2d 149 (1957) noted the significance of the absence of a "saving clause" in the British Convention, stating (at 154):

> "Its omission from the United Kingdom Treaty is further evidence of a purpose to exempt completely income from capital gains belonging to residents of the United Kingdom, regardless of where lodged between the time of receipt and distribution."

The coupling of the saving clause with a tax credit provision adequately serves the purpose of eliminating double taxation but could vitiate reciprocal exemptions.[10]

"Plainly," states respondent (p. 23) "the Convention was addressed to *inter*-national problems; it was not meant to disturb the structure of American tax law as it affects American income of resident American taxpayers." Yet this is precisely what the reversal of the *Biddle* case by

[10] For example, Article X of the Treaty exempts salary from United States tax if paid by the Government of the United Kingdom to a citizen of the United States who is also British. A saving clause would vitiate this provision. Similarly, Article XVI of the Treaty exempts the United Kingdom corporation *inter alia* from United States tax on its accumulated income, with reference to the surtax on unreasonable accumulation of income. This tax would ordinarily apply only in the case of a British corporation carrying on business in the United States and therefore treated under our domestic tax law as a "resident" foreign corporation. It is the overriding quality of the saving clause which no doubt offended the British and made its omission essential, in order to achieve the aim of the British negotiators in placing the tax systems on a reciprocal basis.

Article XIII accomplished. Article XIII revised the structure of the American tax credit for resident American taxpayers solely for United States tax purposes. This aspect of Article XIII is no more "*inter*-national" than the application of the Article XIV exemption to British beneficiaries, and the application of Article XIV is no more or less "*inter*-national" with respect to British income beneficiaries than it is with respect to British remaindermen.

In concluding that "the true goal of the Convention as the proclamation which precedes it announces * * * was 'the avoidance of double taxation and the prevention of fiscal evasion,' altogether foreign to this case," respondent for the first and only time echoes in one sentence the detailed analysis of the Court below, an analysis which in the context of Article XIV and other substantive provisions is demonstrably fallacious. (See Pet. Br. pp. 19-25.) Avoidance of double taxation and the prevention of fiscal evasion were, of course, important objectives from the standpoint of the United States negotiators. Indeed, they were so important that it was necessary to accept the British price of placing the laws on a reciprocal basis with mutual exemptions at the source before joining in a plan for reciprocal enforcement. (Pet. Br. pp. 20-21.) Our goal having been achieved only at the price of important concessions, the concessions made should not be lightly brushed aside.

Respondent's Point C.

In quoting Section 7.519 of the Regulations, T. D. 5569, 1947-2 Cum. Bull. 100, Section 7.519(c), 26 C. F. R. 507.108(c), dealing with beneficiaries of an estate or trust, at page 25 of his brief and his appendix (p. 30), respondent substitutes asterisks for language that makes the regulations patently defective on their face. (Pet. Br. pp. 39-40.)

That part of the regulations, relating to gains resulting from sales or exchanges "by" a British resident, deals with the wrong treaty language. (Res. Br. p. 24; Pet. Br. p. 41; See n. 9, p. 10, *supra.*)

It is a somewhat desperate maneuver to suggest that the Treasury Regulations were "approved" by the British Government. (Res. Br. p. 26.) Surely respondent does not suggest that the British negotiators approved that part of the Regulations which respondent in effect concedes is defective. (Res. Br. p. 25, n. 34; See Pet. Br. pp. 39-40.) The Regulations expressly state that a resident of the United Kingdom who is a beneficiary of a domestic trust shall be entitled to the exemption provided in Article XIV with respect to capital gains to the extent included in his "distributive share"[11] of income of such trust "if he is

[11] The term "distributive share" is somewhat blind. It is not a term used under the provisions of the Internal Revenue Code of 1939 or 1954 relating to the taxation of trust income. The Code provisions speak in terms of "distributable income" and "income which is distributed currently" (Section 162 of the Internal Revenue Code of 1939, 53 Stat. 66 as amended 1942, 56 Stat. 809) and "income required to be distributed currently" and "distributable net income". (Sections 651 and 643 of the Internal Revenue Code of 1954, 26 U. S. C. §§651, 643.) There is no statutory reference to "distributive share", except in the Code provisions relating to the taxation of partnerships. (Section 704 of the Internal Revenue Code of 1954, 26 U. S. C. §704.) As a term of art a "distributive share" of partnership income includes delayed distributions—no matter how long delayed. The regulations dealing with the "transferee liability" of beneficiaries of an estate or trust do speak in terms of the ultimate liability for unpaid taxes on the part of "distributees" to the extent of their "distributive shares", which ordinarily has reference to heirs, devisees, legatees, and remaindermen of trusts. (Treas. Regulations 111, Sec. 29.162-1.) Thus, the term "distributive share" would not appear conclusive on the question of the timing of the distribution, that is to say, whether it refers only to distributed gains or gains retained for future distribution. Respondent assumes a great deal in his reliance on "approval" by the British of this confusing, inept provision in the Regulations.

taxable in the United Kingdom on such income". If this had been read and understood by the British negotiators, they would have realized at a glance that the United Kingdom resident beneficiary would not be "taxable in the United Kingdom on such income" and therefore under the literal words of the Regulation would not qualify for the exemption under Article XIV.[12] Any "simultaneous" issuance of American and British regulations is meaningless since the British have no regulations under Article XIV.

It is incredible to state that "the Regulations have survived to this day without objection". (Res. Br. p. 26.) The Treaty was proclaimed by the President on July 30, 1946, and entered into force as of July 25, 1946, the date of exchange of instruments of ratification. (Res. Br. p. 16, n. 13). *American Trust Company* v. *Smyth, supra,* p. 12, held that Article XIV applied where all the beneficiaries, income beneficiaries and remaindermen alike, were residents of the United Kingdom and the gains were retained for future distribution in a domestic trust. The gains involved in *American Trust Company* v. *Smyth* were derived from the sale of property in 1946. 247 F. 2d at 151. Thus, the Government's interpretation of the Regulations was successfully challenged with respect to gains realized in the first year governed by this Treaty.

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[12] The requirement "if he is taxable in the United Kingdom on such income" is not necessarily unintentional in that it reflects the philosophy of some earlier conventions. It would certainly be appropriate under the Tax Court's interpretation of the Swedish Convention where an effort was made to avoid double taxation without according a complete exemption in both contracting states. See discussion of *Lewenhaupt* v. *Commissioner*, at pp. 11-12, *supra*.

Conclusion.

For the reasons stated in our main brief and above, the judgment of the Court of Appeals should be reversed and the decision of the District Court affirmed.

Respectfully submitted,

D. Nelson Adams,
David A. Lindsay,
John A. Reed,
John A. Corry,
Attorneys for Petitioner
1 Chase Manhattan Plaza
New York 5, New York

Of Counsel:

Davis Polk Wardwell Sunderland & Kiendl
Hill Betts Yamaoka Freehill & Longcope

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